Tour de Fraud: Fraudulent Conveyances

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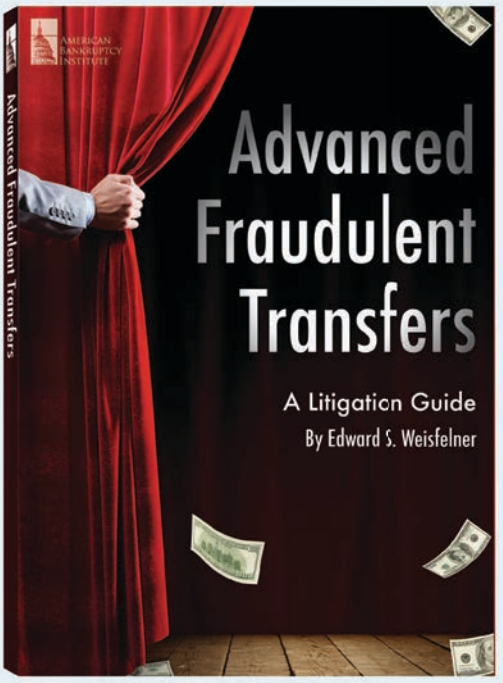

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ASSORTED CONSUMER ISSUES
REGARDING FRAUDULENT TRANSFERS

I. Overview

Section 727(a)(2)(A) provides that debtor may not obtain a discharge if:

[T]he debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition. . . .

11 U.S.C. § 727(a)(2)(A).

In order to succeed with an objection to discharge based on section 727(a)(2), the creditor must prove by a preponderance of the evidence:

(1) that the act complained of was done at a time subsequent to one year before the date of the filing of the petition; (2) with actual intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under the Bankruptcy Code; (3) that the act was that of the debtor or, his duly authorized agent; (4) that the act consisted of transferring, removing, destroying or concealing any of the debtor's property, or permitting any of these acts to be done.

II. Consumer Issues

A. Funding closely held LLC's

Debtors often wish to continue their businesses, but without the debts associated with them. Transfers they make to further these goals are often fraudulent as to creditors. It is always safer to provide full disclosure. *Sundstrom v. Emerging Vision, 374 B.R. 663 (Bankr. E.D. Wis. 2007),* a debtor transferred sole proprietorship assets to a newly-formed, solely owned corporation. Although this conveyance constituted a transfer under the Bankruptcy Code, it did not constitute a fraudulent transfer which

would deny the debtor a discharge. Although the debtor admitted that the debt owed to the former franchisor, and the judgment held by that creditor, was part of the reason for the transfer of the business assets, the debtor received stock of the new corporation in return and there was no diminution in assets available to creditors.

In *Winter v. Welker, 174 F. Supp. 836 (E.D. Pa. 1959)*, debtor with a trucking business had one principal customer. The debtor's wife started her own trucking business and the debtor transferred some of his business assets to her new business. Although the debtor did not assign any contract rights, the principal customer then began doing business with the wife's business. These actions were found to constitute fraudulent conveyances of both tangible and intangible property.

Those individuals who hold interests in an LLC do not become "initial transferees" of payments made to the LLC. Nor do the individuals holding interests in an LLC necessarily qualify as entities for whose benefit a transfer was made under § 550(a)(1). *In re Delta Phones, Inc., 2005 Bankr. LEXIS 2550, 45 Bankr. Ct. Dec. 218 (Bankr. N.D. Ill. Dec. 23, 2005)*

B. Paying family expenses

Transfers are not fraudulent if the proceeds are used to pay ordinary and necessary living expenses for the debtor and his or her family. The funds might also be used to satisfy legal obligations to support dependents. *In re Montalvo, 333 B.R. 145 (Bankr. W.D. Ky, 2005). Gray v. Snyder, 704 F. 2d 709, 10 B.C.D. 566 (C.A4 (N.C.), 1983).*

Transferring the marital homestead solely to the wife while in the face of difficult marital issues was not to be fraudulent when the purpose of the transfer was to be able to permit the wife to continue to provide a home for the children. *In re Prichard, 361 B.R. 11 (Bankr. Mass, 2007).*

On the other hand, the debtor who gave his wife $5,000 to help her buy a Cadillac was held to have committed a fraudulent transfer. His assertion that the funds were delivered in order to provide a safer vehicle for his pregnant wife was not considered sufficient. See *In re Greenfield, 273 B.R. 128 (E.D. Mich., 2002).*

Even payment of expenses for non-traditional family members is not always fraudulent. In *In re Gonzales, 342 B.R. 165 (Bankr. S.D.N.Y., 2006),*

the debtor made mortgage payments for a married but separated woman who he believed to be the father of his child. No paternity order had ever been issued, nor any order for child support. Still, the debtor had for a long time acknowledged the paternity and asserted his fatherhood.

Transfers to joint accounts can also be fraudulent if the debtor does not receive reasonably equivalent value. However, to the extent that the deposits made into the joint bank account are used to pay the debtor's reasonable and necessary living expenses, the transfer will not be found fraudulent. See, for example, *In re Meinen, 232 B.R. 827 (Bankr. W.D. Pa. 1999).*

Transfers to a spouse's separate account were not constructively fraudulent when those funds are used to pay household necessities and joint debts because this meant that the debtor received reasonably equivalent value for the transfer. However the fact that funds were used to pay family and household expenses did not rule out actual fraud. *In re Page, 2012 Bankr. LEXIS 3363 (Bankr. S.D. Ind. July 20, 2012).*

The Trustee could not prove that the debtor committed a fraudulent transfer by paying for more than his share of family expenses, thereby allowing the wife to accumulate funds in her savings account, because the debtor contributed most of the family financial support while the wife contributed most of the household labor. *In re Craig, 144 F.3d 587, 590 (8th Cir. 1998).*

C. Estate planning vs. fraudulent transfer

Estate planning is a legitimate exercise for anyone, including debtors. Debtors, however, should take great care to make sure that estate planning transfers are properly executed. Debtors with fraudulent intent often engage in DIY efforts and often make mistakes. See *In re Associated Enterprises, Inc., 234 B.R. 718; 1999 Bankr. LEXIS 686*, in which the debtor transferred property to a purported trust. The burden of proof as to the existence of a valid trust is on the party asserting that existence. In this case the trust was not properly created and the trustee recovered.

Spendthrift trusts do not constitute assets of the bankruptcy estate. *11 U.S.C. § 541.* Debtors have tried to utilize this exclusion to protect their assets from creditors. In *In re Quaid, 2011 U.S. Dist. LEXIS 132299, 2011 WL 5572605 (M.D. Fla. Nov. 15, 2011)*, a debtor transferred his assets to a self-settled trust, and then claimed the protections of the spendthrift provision which the trust contained. The bankruptcy court held that the

spendthrift provision did not apply to assets in a self-settled trust where the beneficiary is also the settlor. Nearly $400,000 thus came into the bankruptcy estate.

Solvency and timing are the two most critical issues when dealing with transfers supposedly made for estate planning purposes. In *In re Mart, 88 B.R. 436 (Bankr. S.D. Fla. 1988)*, the debtor transferred assets to an irrevocable trust, but did so while he was solvent (only about 10% of his assets were transferred) and at a time when he faced no financial difficulties.

D. Transfers from joint accounts

Whether or not a transfer by the non-debtor joint owner was "permitted" by the debtor is a question of fact. *In re Wingate, 332 B.R. 649 (Banks MC FL 2005).*

Deposits by the debtor into an account for payment of household expenses incurred by both the debtor and his spouse benefit the debtor as well and will not typically constitute a fraudulent transfer. *In re Ducate, 369 B.R. 251 (Bankr. S.C. 2007).*

A fraudulent transfer was found where a debtor emptied a joint account used for family living expenses and then gave one-half of the cash to his wife. The withdrawal occurred less than a week after entry of a judgment against the debtor and his bankruptcy filing was made within days thereafter. *In re Kelsey, 270 B.R. 776 (B.A.P. 10th Cir., 2001).*

E. Divorce complications

Transfers between spouses always draw attention and scrutiny. Such transfers, if made while insolvent or resulting in insolvency, are badges of fraud.

The timing of a divorce, usually immediately prior to a bankruptcy filing, and the speed with which the divorce is completed, are both factors which may evidence the intent to defraud creditors. The size of the matrimonial estate may well have a bearing upon the perceived reasonable time to conclude the divorce. See, for example, *In re Williams, 159 B.R. 648 (Bankr. D.R.I. 1993).*

A 13-day divorce in which the debtor received very little although the debtor was represented and his wife was not resulted in the court inferring collusion. The debtor continued to use the assets which had been transferred and failed to schedule the transfers in his bankruptcy case, even though he was represented in both the divorce and the bankruptcy by the same law firm. Summary judgment was granted denying the debtor a discharge. *In re Boba, 280 B.R. 430; 2002 Bankr. LEXIS 790 (Bankr. N.D. Ill., 2002).*

By itself, however, a transfer between family members does not create a presumption of fraudulent intent. *In re Boyd, 264 B.R. 62; 2001 Bankr. LEXIS 805; 38 Bankr. Ct. Dec. 16.* The testimony of the parties and their demeanor before the tribunal is often the deciding factor. In *Boyd,* the parties transferred property pursuant to a separation agreement, but later reconciled. While on its face this might give rise to an inference of a sham proceeding, the court found the parties' testimony to be credible and that the trustee had not carried his burden of proof.

Transfers pursuant to a collusive divorce decree or property settlement, if intended to hinder, delay or defraud creditors, will, for inadequate consideration, generally constitute a fraudulent transfer under 11 U.S.C. § 548. See, for example, *In re Clausen, 44 B.R. 41 (Bankr. D. Minn. 1984)(divorce decree).*

An inequitable division of assets in divorce, or deviation from statutory standards without good reason, may be evidence of fraudulent intent. On the other hand, there can be reasonable explanations. In *In re Sorlucco, 68 B.R. 748; 1986 Bankr. LEXIS 4674,* a wife did not seek to recover properties used by her husband for liaisons with other women. While she may have received less than an equal split generally applied under New York law, the court found a reasonable basis for that deviation.

On the other hand, even an equal distribution can be fraudulent. *In re Beverly, 374 B.R. 221; 2007 Bankr. LEXIS 2574*, a lawyer facing a large malpractice claim colluded with his spouse to divide the marital assets relatively equally. The debtor received all exempt assets while the non-debtor wife received non-exempt funds. Although the bankruptcy court found no actual intent to defraud, the case was reversed on appeal to the 9th Circuit BAP.

A transfer of assets in return for a waiver of a claim for maintenance may be fair consideration. *In re Fair, 142 B.R. 628 (Bankr. E.D.N.Y., 1992).*

Similarly, disparate division of assets is not found to be fraudulent when based upon moral grounds. Although the debtor husband received a smaller distribution in the divorce, that amount was less because he had taken retirement money without permission to invest in a restaurant. There was no evidence that the divorce was a sham, nor the distribution an attempt to defeat creditor claims. *In re Kimmell, 480 B.R. 876 (Bankr. N.D. Ill., 2012).*

Non-collusive, arms-length negotiated marital settlement agreements are not likely to be successfully attacked as fraudulent transfers. Bankruptcy courts may well give deference to the family court. The tax is based upon a lack of reasonably equivalent consideration so long as the actual consideration appears to be within a reasonable range that the state court might order. Such an approach is especially likely if the fraudulent transfer attack is made by a debtor-in-possession who is a party to the arms-length negotiations. See *In re Falk, 88 B.R. 957; 1988 Bankr. LEXIS 1130; Bankr. L. Rep. (CCH) P72,414; 19 Collier Bankr. Cas. 2d (MB) 523; 18 Bankr. Ct. Dec. 33.*

Collusion may be found simply by default. The defaulting party may by doing so "permit" the transfer of assets. In *In re Clausen, 44 B.R. 41; 1984 Bankr. LEXIS 4894; Bankr. L. Rep. (CCH) P70,103; 12 Bankr. Ct. Dec. 584,* the court found that a default divorce judgment evidenced the intent of the debtor "very clearly."

On the other hand, transfers of assets by the debtor's spouse while the parties were having serious marital problems, and without the knowledge of the debtor, will not give rise to a presumption of permission by the debtor or an intent to defraud. *In re Wingate, 377 B.R. 687 (Bankr. M.D. Fla., 2006).*

Failure to divide property equally may give rise to a challenge under § 548(a) that the debtor was insolvent and received less than reasonably equivalent value in the transfer. In *In re Kaczorowski, 87 B.R. 1; 1988 Bankr. LEXIS 983,* failure to follow the advice of bankruptcy counsel in structuring a divorce settlement resulted in the recipient wife losing the equity which was transferred by her debtor husband. The bankruptcy attorney recommended an equivalent value exchange, but the parties instead had the debtor transfer his only significant asset as a "lump-sum alimony" payment. Compounding problems, the divorce was not completed and the parties resumed their marital relations without the debtor having left the family home.

Contested or heavily-litigated divorces often pass the "badges of fraud" test. A divorce "which was fully litigated, without any suggestion of collusion, sandbagging, or indeed any irregularity…should not be unwound by the federal courts merely because of its unequal division of marital property." *In re Erlewine, 349 F.3d 205 (5th Cir. Tex. 2003).*

In *In re Riso, 102 B.R. 280 (Bankr. D. N.H. 1989),* the court found that, since a property settlement agreement was within the range of results that could be expected had a state court ordered equitable distribution of property in the debtor's divorce case, the debtor had not conveyed property for less than reasonably equivalent value even though he had received only 42% of the marital property. The release from further property settlement obligations that the debtor might have had in addition to one half of the marital property was considered to be reasonably equivalent value given in exchange for the property transferred which exceeded one half of the total marital property.

Likewise, a transfer in exchange for something that has no immediate value to the bankruptcy estate may still be deemed a transfer for reasonably equivalent value. Thus, in *In re Roosevelt, 176 B.R. 200 (B.A.P. 9th Cir. 1994),* the BAP for the Ninth Circuit held that a debtor's transfer of real estate and a partnership interest in compensation for his wife's interest in his medical practice was not a fraudulent transfer, even though the interest in the medical practice had no monetary value. The court held that the debtor had received a valuable asset which would produce an income stream to pay creditors and that reasonably equivalent value had been given for the transfer.

F. Running expenses through business

In *In re Antex, Inc., 397 B.R. 168; Bankr. LEXIS 3649; 61 Collier Bankr. Cas. 2d (MB) 15; 50 Bankr. Ct. Dec. 366,* the debtor was a corporation in an involuntary Chapter 7 case. The debtor's principal was subject to various family court orders requiring support of his ex-wife and minor children. To satisfy this obligation, he wrote multiple checks totaling nearly $70,000 from the debtor-corporation's bank accounts. These checks were delivered by the debtor-corporation directly to the ex-wife and were found to constitute fraudulent transfers. The ex-wife provided neither services nor any other consideration to the debtor-corporation.

Sometimes the transfers may be difficult to value, but still be found fraudulent. In *In re Coady, 588 F.3d 1312 (11th Cir., 2009),* a debtor owed millions of dollars in debt. He married and moved into a home owned by the wife. He drove a car which she leased and worked for various businesses owned by her. He received no salary, but was allowed to write checks on her business accounts to pay for his personal expenses. The wife also paid for his country club and golf club memberships. His discharge was denied on the grounds that he had "diverted the fruits of his labor to increase the value of his wife's businesses and then used business assets to support his personal lifestyle." The court found that this arrangement enabled the debtor to acquire and conceal an equitable interest in the businesses of his wife. See also, *In re Ogalin, 303 B.R. 552,558 (Bankr. D. Conn., 2004).* This would not appear to be the law in the 7th Circuit, for an argument that services provided to a wife's business constitute an asset which can be transferred under the Uniform Fraudulent Transfer Act. *Bressner v. Ambroziak, 379 F.3d 478 (7th Cir., 2004).*

CURRENT AND EMERGING TOPICS IN BUSINESS FRAUDULENT TRANSFER LAW

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CURRENT AND EMERGING TOPICS IN BUSINESS FRAUDULENT TRANSFER LAW

I. Overview

A. This presentation is not intended to be an exhausted discussion of fraudulent transfer law. Rather, it will be a review of interesting and emerging topics in fraudulent transfer law and litigation involving commercial entities.

B. Some basics[1]:

1. Fraudulent transfer actions are creditors' rights actions.

2. They are intended to remedy situations where debtors (obligors) dispose themselves of valuable assets (or incur additional debts) while still bearing unpaid debts.

3. While solvent debtors can generally give away assets with impunity, subject to fiduciary obligations and other legal restrictions, a financially distressed (*i.e.*, (i) insolvent, (ii) unreasonably small capital, or (iii) debts beyond debtor's ability to pay) debtor's transfer of assets may be avoided unless it receives "reasonably equivalent value" in return (because creditors look to the debtor's assets for the payment of claims).

4. Depending on the jurisdiction, state and/or federal bankruptcy law provides that if assets are transferred under certain circumstances in the two/four/six years before a bankruptcy filing, or insolvency (or similar distressed circumstance), that transfer may be undone or "avoided."

[1] For a more complete review of basic fraudulent transfer law and its history, see attached, Chapter 17, Fraud And The Bankruptcy Code, (Chapter 17 authors, Robert A. Weisberg, Lawrence A. Lichtman, Christopher A. Grosman and Patrick J. Kukla), *The Handbook of Fraud Deterrence*, H. Cendrowski, J. Martin and L. Petro, John Wiley & Sons, Inc., 2007.

Creditors (outside of bankruptcy) or debtors/trustees (in bankruptcy) can seek to avoid transfers made "with actual intent to hinder, delay, or defraud" creditors (*i.e.*, actual fraud or intentionally fraudulent transfer).

5. Fraudulent transfers also include transfers which were either not at all fraudulent, or at least don't need to be proved to be. These are called constructively fraudulent transfers. A constructively fraudulent transfer occurs when the debtor filing bankruptcy simply gets "less than a reasonably equivalent value in exchange for such transfer or obligation" while in one of several financially distressed circumstances.

6. The relevant statutes addressing fraudulent transfer law are contained in the federal Bankruptcy Code as well as similar state statutes. See 11 U.S.C. §§ 544, 546, 548, and 550, and the Uniform Fraudulent Transfer Act (the "UFTA") (adopted by 43 states, District of Columbia, and the U.S. Virgin Islands; the Uniform Fraudulent Conveyance Act is still in place in NY and MD).

7. Currently the National Conference of Commissioners on Uniform State Laws has drafted a proposal with respect to potential amendments to the UFTA. As of this date, the draft has not been passed by the National Conference of Commissioners on Uniform State Laws or the Drafting Committee. Accordingly, it is unclear at present, whether such proposed amendments will be adopted by the states adopting the UFTA.

II. The Terrible "T's": *Tronox*, *Tousa*, and *Tribune*. Three relatively recent cases: *In re: Tronox, In re: Tousa*, and *In re: Tribune*, are instructive in that they cover a panoply of issues typically arising in fraudulent transfer cases.

A. *Official Committee of Unsecured Creditors of Tousa, Inc. v. Citicorp North America, Inc. (In re: Tousa, Inc.)*, 422 B.R. 783 (Bankr. S.D. Fla. 2009)("Tousa I"), rev'd 444 B.R. 613 (S.D. Fla. 2011) ("Tousa II"), aff'd *Senior Transeastern Lenders v. Official Committee of Unsecured Creditors*, 680 F.3d 1298 (11th Cir. 2012) ("Tousa III").

TOUSA and its subsidiaries were in the business of designing, constructing, marketing, and selling residential homes and real estate developments and were caught by the housing collapse and particularly its impact on the Florida market. In June 2005, Homes LP (a wholly-owned subsidiary of TOUSA) formed a joint venture ("JV") with a third party to acquire the assets of a home builder in Florida. The JV incurred debt to certain lenders ("Transeastern Lenders"). TOUSA and Homes LP executed guaranties in favor of the Transeastern Lenders (no other subsidiary of TOUSA was liable for this debt).

Demand was made on TOUSA and Homes LP under the guaranties and a lawsuit was subsequently filed. TOUSA secured loans of approximately $50 million dollars (made by "New Lenders") to settle with the Transeastern Lenders and pledged the assets of certain of its subsidiaries (the "Conveying Subsidiaries") as collateral for the loans made by the New Lenders, effectively "upstream guaranties". Proceeds of the loans made by the New Lenders were used to pay/settle with the Transeastern Lenders.

Six months later, TOUSA and the Conveying Subsidiaries filed bankruptcy. The Creditor's Committee, on behalf of the Debtors' estates, brought an action to claw back the loan proceeds paid to the Transeastern Lenders and to undo the liens on the Conveying Subsidiaries' assets granted to the New Lenders.

The Bankruptcy Court found in Plaintiffs' favor. It discounted "soft benefits" as constituting reasonably equivalent value. The Court found that the subsidiaries had no ability to enforce such benefits. The evidence further indicated that TOUSA and its subsidiaries recognized the precarious nature of the housing market as early as 2006 and that it was overleveraged. While the District Court reversed the findings of the Bankruptcy Court, holding that "soft benefits" could be quantified and establish sufficient value to preclude fraudulent transfer liability, the Eleventh Circuit concluded that even if the items which the Defendants asserted as value were considered in the calculation of reasonably equivalent value, such calculation would still result in a lack of reasonably equivalent value.

The Bankruptcy Court addressed many issues, including, the good-faith of the transferees and the quality of expert testimony, including a critique of a "bottoms-up versus a "top-down" approach. The standards for determining insolvency and reasonably equivalent value under both the UFTA and section 548 of the Bankruptcy Code (including the role of "soft benefits" on both calculations) and whether a savings clause would be effective to insulate the Defendants from liability were also considered.

B. *Tronox, Inc. v. Kerr McGee Corp. (In re: Tronox, Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013).

Tronox involved a complex series of transactions resulting in a spinoff of the Debtor's oil and gas assets, leaving the Debtor with the titanium dioxide business previously operated by Kerr-McGee Corp. ("Old Kerr-McGee"). Old Kerr-McGee was burdened with enormous legacy, environmental and tort liabilities. Starting in 2000, one of Old Kerr-McGee's investment bankers, Lehman Brothers, made presentations to Old Kerr-McGee's board to initiate a transfer of the oil and gas assets to a new company known as Kerr-McGee Corporation ("New Kerr-McGee"), leaving New Kerr-McGee in a position to disclaim responsibility for the legacy liabilities. Plaintiffs contended that these steps were part of a general plan to split the oil and gas assets from the remaining assets that would be left behind with all the legacy, environmental and tort liabilities. The Court found that the process utilized to spinoff such assets was the goal from the outset in 2000. Ultimately, the titanium dioxide business resided with Debtors. Various testimony indicated that the spinoff was designed to "alleviate" the environmental burden from Kerr-McGee, and that it was a "pure play" and a "cleaner" separation of the Titan (Old Kerr-McGee) liabilities.

Following the spinoff, Tronox began to struggle almost immediately, ultimately resulting in a Chapter 11 filing. The relevant litigation was teed up after the environmental authorities and tort plaintiffs of Tronox agreed to accept, as their bankruptcy distribution, the proceeds of the lawsuit ultimately pursued by a litigation trust plus certain cash consideration for their claims. Claims were made under the Oklahoma UFTA, section 548 of the Bankruptcy Code, and

various other statutes and legal theories. The Bankruptcy Court for the Southern District of New York, Judge Gropper, found in Plaintiffs' favor, finding the spinoffs to be fraudulent transfers and providing for further proceedings to determine damages, which Judge Gropper indicated would be in the range of $5 – $14 billion. The matter has since settled for approximately $5 billion.

C. *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310 (S.D.N.Y. 2013)

Prior to filing for bankruptcy, Debtor (Tribune Co.) was the subject of an LBO that resulted in approximately $8 billion being paid out to Tribune shareholders. In an effort to avoid the section 546(e) safe harbor defenses of the shareholders who received LBO payments for their shares, the Debtor's plan provided that intentional fraudulent transfer claims (which are not barred by section 546(e)), were transferred to a litigation trustee. Since the estate representative was limited to bringing actual fraudulent transfer claims against shareholders, the Debtors' estates disclaimed the right to assert constructive fraudulent conveyance claims against shareholders. Instead, those claims would revert back to individual creditors to pursue.

III. Standing to Bring Claims

A. 11 U.S.C. §§ 544(b), 548, 1101(1) and 1107(a) provide trustees and debtors-in-possession with the ability to pursue fraudulent transfers.

B. While the UFTA is described as a creditor remedy, and the creditor is contemplated to be the pursuing party, the Bankruptcy Code provides a direct remedy for a trustee or debtor-in-possession to pursue fraudulent transfers in lieu

of, and on behalf of, creditors. 11 U.S.C. § 548. Additionally, such plaintiff contemplated by the Bankruptcy Code may also pursue state law fraudulent transfer remedies pursuant to 11 U.S.C. § 544(b).

C. Creditor's committees may also pursue fraudulent transfers upon leave, or pursuant to a confirmed plan of reorganization. *Smart World Technologies, LLC v. Juno Online Services, Inc. (In re: Smart World Technologies, LLC)*, 423 F.3d 166, 176 (2d Cir. 2005); *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re: Cybergenics Corp.)*, 330 F.3d 548, 583 (3d Cir. 2003).

IV. Intentionally Fraudulent Transfer

A. Intentionally fraudulent transfers, which can be avoided under state and federal law, include transfers made (or obligations incurred) with actual intent to hinder, delay, or defraud creditors. 11 U.S.C. § 548(a)(1)(A), and UFTA § 4(a)(1). Courts typically look to certain "badges of fraud" in determining whether actual intent to defraud existed. These "badges" are identified in the UFTA, section 4(b).

B. The *Tronox* Court found that there was actual intent to hinder or delay creditors under the Oklahoma version of the UFTA, despite its disclosure in its S-1 that the transfers were taking place. *Tronox,* at 277.

C. The *Tronox* Court also pointed to the existence of five badges of fraud:

1. The transfer to an insider;

2. Debtor retained control after transfer;

3. Transfer was concealed (Court finding there was ineffective disclosure);

4. Debtor had been previously sued; and

5. Transfer was substantially all of Debtor's assets.

Tronox, at 285-286.

V. Constructively Fraudulent Transfer – Conditions Of Financial Distress

A. Recovery of constructive fraudulent transfers requires an imperiled financial condition of the debtor (and receipt of less than reasonably equivalent value – discussed in Section VI. below). The relevant fraudulent transfer statutes look to a balance sheet insolvency whereby (i) the fair market value of the assets exceeded the debtor's liabilities at the time of the transfer, 11 U.S.C. § 101(32), 11 U.S.C. § 548(a)(1)(B)(ii)(I), UFTA § 2(a), (ii) a cash flow insolvency whereby the debtor was unable to pay its debts as they came due, 11 U.S.C. § 548(a)(1)(B)(ii)(III), UFTA §2(b), and (iii) the debtor was lacking adequate capital to run its business, 11 U.S.C. § 548(a)(1)(B)(ii)(II).

B. **The Test(s)**

1. Insolvency

a. *Tousa*

i. In determining solvency, the *Tousa* Court recognized the balance sheet test under 11 U.S.C. § 548(a)(1)(B)(ii)(I). *Tousa I,* at 858.

ii. Fair value is fair market price where debtor is a going concern. *Tousa I*, at 858.

iii. The Court recognized methods of (i) discounted cash flow, (ii) comparable companies, and (iii) observable market value to determine total enterprise value – a proxy for the fair value of the assets. *Tousa I,* at 823-825 and 859-61.

iv. Observable market value is market value of publicly traded debt and equity securities less cash – this is what it would take to purchase claims on all of company's assets. *Tousa I*, at 825-826.

v. Plaintiffs used expert to perform three separate balance sheet analysis using real estate valuation as determined by its real estate expert. *Tousa I*, at 825.

vi. Plaintiffs used consolidated approach for insolvency analysis after transaction because all subsidiaries were liable on challenged debt. *Tousa I*, at 825.

b. *Tronox*

i. The *Tronox* Court also acknowledged that the analysis of solvency for fraudulent conveyance purposes is a "balance sheet test," examining whether debts in the aggregate are greater than assets in the aggregate and that both assets and debts must be determined "at a fair valuation." *Tronox*, at 296 (internal citations omitted).

ii. However, the Court noted that these deceptively simple terms generally (and did in this case) engendered days of expert testimony. *Tronox*, at 296.

iii. Unlike *Tousa*, the *Tronox* Court rejected Defendants argument that a solvency (and reasonably equivalent value) analysis must be performed on a strict entity-by-entity basis. *Tronox*, at 293-94.

iv. The *Tronox* Court found that a Bankruptcy Code determination of solvency was almost identical to UFTA. *Tronox*, at 296.

v. The *Tronox* Court looked at the market evidence first, while recognizing that Plaintiffs' expert was well known for relying on the market rather than ex-post analysis. *Tronox*, at 296.

vi. While not rejecting a public market solvency test, the Court criticized Defendants' expert for relying on faulty and deficient market evidence, thus finding the market evidence deficient. *Tronox,* at 297-299 (market participant was not bound to transaction; IPO disclosures were flawed). The Court also found no substitution for a solvency test. *Tronox,* at 303.

vii. The *Tronox* Court did recognize three leading cases in which the market controlled the analysis as opposed to

other methodologies/tests. *VFB, LLC v. Campbell Soup Co*., No. Civ. A 02-132, 2005 U.S. Dist. Lexis 19999, 2005 WL 223 4606 at 31 (D. Del. Sept. 13, 2005) aff'd 482 F.3d 624, 632-34 (3d Cir. 2007); *Iridium Operating, LLC v. Motorola, Inc. (In re: Iridium Operating LLC)* 373 B.R. 283, 352 (Bankr. S.D.N.Y. 2007)) and *In re: OldCarco, LLC (f/k/a Chrysler, LLC)*, 454 B.R. 38, 59-60 (Bankr. S.D.N.Y. 2011).

c. In *Campbell Soup*, the Third Circuit determined that the traded stock price was the most reliable indicator of fair market value and relied upon that and equity markets as opposed to experts. *Campbell Soup*, at *78. The Court went on to criticize discounted cash flow valuations. *Campbell Soup*, at *98-105.

2. Inadequate Capitalization

a. In addressing unreasonably small capital, the Court cited with approval *Moody v. Security Pacific Business Credit, Inc*., 971 F.2d 1056, 1075 (3d Cir. 1992), in holding that unreasonably small capital is short of equitable insolvency – an inability to generate cash for operations. *Tousa I*, at 862. See also *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 794 (7th Cir. 2009).

b. The length of the interval between transaction and failure is relevant, but there should not be a bright line test on whether a certain time of survival supports solvency. *Boyer*, at 795.

3. Inability to Pay Debts

a. The *Tronox* Court explained that this "[t]est has a subjective and objective element, *i.e.*, that the debtor was objectively unable to pay its debts or reasonably should have come to that conclusion." *Tronox*, at 324.

b. Most of the cases view the objective test relating to a debtor's ability to pay debts as more short-term than the unreasonably small capital test. *Tronox*, at 324.

C. **The Evidence**

1. What an issuer's stock and debentures trade for in the public markets has nothing to do with proving the issuer's insolvency under section 101(32). *Tousa I*, at 827 and 860.

2. While the market may be looked to for a determination of insolvency, it is not the last word. An IPO as a market measure of insolvency was minimized since the financial statements used did not properly reserve for the environmental claims and were viewed as "sell side" projections. *Tronox*, at 298-9 and 301-2.

3. The lenders were assured of payment although creditors were not, thus discrediting their lending as market evidence of solvency. *Tronox*, at 298. Also, the one market buyer had "outs". *Tronox*, at 304-5.

4. The *Tousa* Court looked at:

a. Overall market collapse. *Tousa I,* at 790.

b. Fact that lender harbored doubts regarding solvency. *Tousa I,* at 796 – 797.

c. Influences on decision to do deal as being critical. Personal incentives to CEO and top advisors to do deal were cited as instructive. *Tousa I,* at 798.

d. Internal memos as instructive. The company recognized that capital would be tight and that debts were not being paid. *Tousa I*, at 798-99 and 802.

5. The *Tousa* Court found unreasonably small capital due to high debt to capitalization ratio and management observations. *Tousa I*, at 830.

6. The *Tousa* Court also found debtor was unable to pay debts. Bonds trading at low levels was evidence of default/inability to pay. *Tousa I*, at 830.

VI. Constructively Fraudulent Transfer – Reasonably Equivalent Value ("REV")

A. The Test(s)

1. Recovery of constructive fraudulent transfers requires receipt of less than REV (and an imperiled financial condition of the debtor– discussed in Section V. above). 11 U.S.C. § 548(a)(1)(B)(i) and UFTA §§ 4(a)(2) and 5(a).

2. In addressing valuation approaches, courts, in the context of foreclosure actions, have disregarded arbitrary formulaic approaches to evaluation as was first set forth in *Durrett v. Washington National Insurance Co*., 621

F.2d 201(5th Cir. 1980) (purchase for less than 70% of fair market value was considered avoidable (the 70% rule)).

3. In *BFP v. Resolution Trust Corp*., 511 U.S. 531, 544 (1994) the U.S. Supreme Court rejected arbitrary formulaic approaches to valuation (like that set out in *Durrett, supra*) and adopted a totality of circumstances approach for valuation in the context of foreclosures.

4. *Tousa*

   a. One of the key questions in *Tousa* concerned the receipt of REV by subsidiaries that had incurred liability by granting liens on their property to secure debt owed by their parent. The Bankruptcy Court:

      i. Initially supported a narrow definition of "value" finding that possible avoidance of bankruptcy and other "indirect" benefits could not serve as value. *Tousa III*, at 1304 and 1309. In alternative findings, the Bankruptcy Court assessed the value of the indirect benefits arguably provided to the conveying subsidiaries under the broadest definition of value proposed by the Defendants and still found a lack of REV. *Tousa III*, at 1304.

      ii. Found that REV must be cognizable – property or debt satisfied. *Tousa I*, at 868

iii. Found that REV must be in exchange for what is given – cannot be benefit which would have been realized in any event. *Tousa I*, at 866.

iv. REV cannot be valued on a consolidated basis as section 548 talks in terms of debtor (in the singular) recovering value. *Tousa I*, at 833-34, and 867.

b. The District Court rejected the Bankruptcy Court's decision as too narrow and potentially "inhibitory of contemporary financing practices". *Tousa II*, at 659 and *Tousa III*, at 1309.

c. However, the Eleventh Circuit Court of Appeals refused to reach the issue of whether "avoidance of bankruptcy" can confer value. Instead, it relied on the Bankruptcy Court's alternative determination that, even if all the benefits of the transaction were legally cognizable, they did not confer REV. *Tousa III*, at 1311. According to the Court of Appeals, such determination was not clearly erroneous and, therefore, was upheld. *Tousa III*, at 1311.

5. *Tronox*

a. Defendants claimed that the REV analysis should be done on an entity-by-entity basis, relying on *Tousa*. *Tronox,* at 293-94.

b. The Court distinguished *Tousa* based on the fact that no creditors of Tronox treated subsidiaries as separate entities and that, in *Tousa,* the Eleventh Circuit found that there was no REV on a consolidated basis in any event. *Tronox,* at 294.

c. The Court rejected Defendants' argument that REV (and solvency) analysis must be performed on a strict entity-by-entity basis. *Tronox*, at 293-94.

d. In determining if REV should be assessed on a consolidated basis, the Court also relied on the creditor's perspective holding that: "in carrying out the intent of the fraudulent conveyance laws, courts disregard the form of a transaction and look 'instead to its substance' . . . . [and] that fraudulent conveyance law is 'designed to protect creditors' rights' and looks at transactions from 'the perspective of creditors'." *Tronox,* at 295 (internal citations omitted.)

6. It is not unusual, however, for indirect benefits to be recognized as value. See *In re Xonics Photochemical, Inc*., 841 F.2d 198, 202 (7th Cir. 1988) (benefit due to use of non-debtor's distribution system); *Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide, Ltd.),* 139 F.3d 574, 578 (7th Cir. 1998) (benefits of keeping supply to corporate group recognized as value).

B. **The Evidence**

1. *Tousa*

a. No direct benefits. *Tousa I*, at 844.

b. Indirect benefits – continued to get support from parent even after bankruptcy so no benefit to keeping parent alive. *Tousa I*, at 846.

c. No direct benefit to avoiding bankruptcy of parent. Subsidiaries held all assets. *Tousa I*, at 846.

d. Bankruptcy was likely with or without transaction. *Tousa I*, at 846.

e. No improvement in operations. *Tousa I*, at 845.

2. *Tronox*

a. The Court found that the facts supported quantifying REV on a consolidated basis, finding:

i. There was no contention that any creditor relied on any entity's separate identity.

ii. Tronox operated its business and handled its environmental liabilities on a consolidated basis.

iii. All liabilities were funded out of a central cash management system.

iv. Tronox was marketed as a consolidated entity in its IPO, and each of the Plaintiffs became liable on the debt issued as either a borrower or a guarantor.

v. The "market" dealt with Tronox on a consolidated basis.

Tronox, at 293-95.

b. Defendants did not challenge expert's calculations. *Tronox*, at 292-93. The only challenge to REV (other than on the consolidation issue) related to forgiveness of an intercompany debt which the Court found was neither supported by the evidence nor

would change the REV determination. If it existed, the Court found it to be equity. *Tronox*, at 292.

3. The Sixth Circuit in *Global Technovations, Inc.*, 694 F.3d 705 (6th Cir. 2012) concluded that the lower Court's valuing of indirect benefits was not error, while recognizing that the standard of review was clear error (and that a split in the circuits exist).

VII. Recovery In Excess Of Creditors' Claims

A. While under applicable provisions of the UFTA, the recovery by a plaintiff creditor is usually limited to the amount of the creditor's claim, a plaintiff/trustee pursuing a fraudulent transfer under the Bankruptcy Code may pursue such a claim if even one creditor exists from the time of the fraudulent transfer (a "triggering creditor"), notwithstanding the amount of such creditor's claim. See *Moore v. Bay*, 284 U.S. 4, 5 (1931).

B. What if the transfer in question is made by a subsidiary or affiliate of the debtor? In the case of *Adelphia Recovery Trust v. Bank of America, N.A.,* 390 B.R. 80 (S.D.N.Y. 2008), aff'd 379 Fed. Appx. 10 (2d Cir. 2010) cert dismissed 131 S. Ct. 896 (2011), the Court held that neither a debtor/parent nor parent creditors could avoid, as fraudulent transfers, transfers by a subsidiary, based upon the conclusion that the Plaintiff was not a creditor of the subsidiary and claims could only be brought for the benefit of creditors. *Adelphia*, at 94. *Adelphia* relied further on state law causes of action asserted under section 544(b) and found that a fraudulent transfer could only be asserted by unpaid creditors. *Adelphia*, at 92.

Because in *Adelphia* the relevant creditors of the subsidiary had been paid in full, the Court concluded that no unsecured creditors of the subsidiary existed. *Adelphia*, at 97.

C. The Fifth Circuit has permitted pursuit of a fraudulent transfer based upon the existence of a "triggering creditor" as of the filing of the case even though debtor's creditors had been paid in full under a plan. *MC Asset Recovery LLC v. Commerzbank A.G. (In re: Mirant Corp.*), 675 F.3d 530 (5th Cir. 2012). The *Mirant* Court recognized that the only limitation on the fraudulent transfer recovery was to the extent that the avoided transfer "benefits the estate" as opposed to the amount of unsecured creditors' claims. See 11 U.S.C. §§ 544(b) and 548 which provide for no limitation in connection with "benefit to the estate." Additionally, 11 U.S.C. § 550 has no limitation on recovery in setting aside a fraudulent transfer. Thus, to the extent that a triggering creditor exists at the case onset, the avoided transfer may, in theory, not be required to benefit the estate.

D. Addressing what it considered the most complex issue in the case, the *Tronox* Court did not limit potential recovery to the interest of creditors only, but held that other benefits to the estate could serve as a basis for unlimited recovery. *Tronox,* at 327-330. The *Tronox* Court found that the Defendant suffered a diminution in value of approximately $14 billion. In a prior decision, *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox, Inc.)*, 464 B.R. 606, 609 (Bankr. S.D.N.Y. 2012), the Court found that 11 U.S.C. § 550(a) did not cap Defendants' liability to the amount of unpaid unsecured creditors' claims, potential recovery could range from $5 to $14 billion. The Court rejected Defendants' arguments

that section 550 limiting recoveries to those that "benefit the estate" and principles of equity could serve as a basis for limiting damages to the amount of unsatisfied claims. Instead, the Court held that the Defendants could be liable for the full value of the transferred assets, though the Court did indicate that a claim could be "offset" based upon the Defendants' section 502(h) claim.[2] This holding significantly limited the impact of the holding in *Adelphia* by finding that *Adelphia* only limited recovery where creditors could not possibly benefit and where only Debtor would benefit. *Adelphia,* at 616. See also, *Boyer,* at 787.

E. The Court found that prior creditors (bondholders) of Tronox, Inc., although paid under the Plan, could still serve as triggering creditors – even if they had ratified (although did not participate in) the transfers in question. *Tronox*, at 275-6.

F. *Crescent Res. Litig. Trust v. Duke Energy Corp.*, 500 B.R. 464 (W.D. Tex. 2013).

1. The Court refused to limit damages to claims of creditors that could have brought state court fraudulent transfer action based upon plain language of section 544(b) (explaining that the *Moore v. Bay, supra,* rule was too ingrained in precedent to evade simply by way of a nuanced reading of section 544(b)). *Crescent*, at 481-2.

2. However, the Court did limit fraudulent transfer recovery based upon equitable premises underlying section 550(a). The Court noted that "there are numerous examples of cases where courts have denied or limited recovery based on the equitable principles underlying the Bankruptcy Code and section 550(a) in particular." *Crescent*, at 481-82.

[2] Interestingly, as of March, 2014, the *Tronox* claim was settled, purportedly for an amount at the low range of recovery as set forth in the *Tronox* Court's opinion.

G. An alternative to requiring a direct creditor of a subsidiary to be a triggering creditor is to assert an alter ego theory by the debtor/parent against the subsidiary, thereby making the parent's creditors triggering creditors. But see*, Nieto v. Unitron*, Docket No. 06-11966, 2006 U.S. Dist. LEXIS 54443 (E.D. Mich. August 7, 2006) (Holding that, under Michigan law, the chapter 7 trustee did not have standing to pursue an alter ego claim.), *In re: RCS Engineered Products*, 102 F.3d 223 (6th Cir. 1996)(same) and *RDM Holdings, Ltd. v. Continental Plastics Co.*, 281 Mich. App. 678, 704-707 (2008) (same). See also, *U.S. Bank, N.A. v. Verizon Communications, Inc*., 479 B.R. 405 (N.D. Tex. 2012) (Recognizing a lack of corporate distinction between parent and subsidiaries in a fraudulent transfer matter).

VIII. 546(e) Safe Harbor Protections

A. Section 546(e) provides a "safe harbor" exempting from avoidance by "the trustee" any "margin payments," "settlement payments" and transfers in connection with "securities contacts," "forward contracts" and "commodity contracts" made by, to or for the benefit of certain parties such as stockbrokers and financial institutions. Section 546(e) provides, in relevant part:

> . . . the trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e). Courts generally have expanded the scope of the section 546(e) safe harbor by interpreting it broadly to cover a wide range of transactions.

B. Section 546(e) has been used to insulate payments made in connection with non-public purchase of stock in an LBO and in which the financial institution involved was found to not necessarily have had a beneficial interest in the payment. *QSI Holdings, Inc. v. Alford (In re: QSI Holdings, Inc.)*, 571 F.3d 545 (6th Cir. 2009). See also *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 590 F.3d 252 (3d Cir. 2009).

C. In fact, even securities transactions which may have not existed at all due to a ponzi scheme have been held to protect payments in connection with such illusory transactions. See *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff Sec.)*, 476 B.R. 715 (S.D.N.Y. 2012) on appeal, Docket No. 12-2557 (2d Cir. 2012).

D. In light of the broad application of section 546(e) in insulating otherwise recoverable transfers, the "work around" was created.

E. *Edward S. Weisfelner, as Litigation Trustee of the LB Creditor Trust v. Fund 1., et al. (In re Lyondell Chemical Company, et al.)*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014).[3]

1. Prior to filing for bankruptcy, Debtor was the subject of an LBO pursuant to which it incurred $21 billion in secured debt and paid out approximately $12.5 billion of the debt to shareholders.

2. In an effort to avoid the section 546(e) safe harbor defenses of shareholders, the Debtor's plan provided that creditors would assign their

[3] An appeal of the *Lyondell* decision is expected.

avoidance claims to a Creditor Trust (and the Debtor would abandon its state law fraudulent transfer claims under section 544). The Trust asserted exclusively state law fraudulent transfer claims (on behalf of the creditors that had assigned them to the Trust).

3. Defendant shareholders contended that the section 546(e) safe harbor preempted state-law based fraudulent transfer claims (even if being pursued by individual creditors).

4. The Bankruptcy Court rejected the Defendants' preemption argument and held that section 546(e) does not bar fraudulent transfer claims brought by an entity other than the bankruptcy trustee (or its successors) under state fraudulent transfer laws.

F. *In re Tribune Co Fraudulent Conveyance Litig.*, *supra.*[4]

1. In an effort to avoid the section 546(e) safe harbor defenses of Tribune shareholders who received LBO payments for their shares, the Debtor's plan provided that intentional fraudulent transfer claims (which are not barred by section 546(e)), were transferred to a litigation trustee.

2. The state law constructive fraudulent conveyance suits that were filed against the shareholders that received LBO payments were consolidated into a multidistrict litigation in the U.S. District Court for the Southern District of New York.

[4] The *Tribune* and *Whyte* (see below) decisions have been appealed to the Second Circuit. Case Nos. 13-2653 (2d. Cir.), ECF Nos. 192-93, 198; 13-3992 (2d Cir.), ECF Nos. 33-34, 37. The Lyondell Creditor Trust has filed an appearance as amicus counsel.

3. In the multidistrict litigation, the shareholder Defendants argued that section 546(e) preempted the creditors' state law constructive fraudulent conveyance claims.

4. The District Court held that, by its plain language, the section 546(e) safe harbor for securities transaction settlement payments applies only to protect such payments against fraudulent transfer avoidance actions brought by a bankruptcy trustee and does not preclude state law constructive fraudulent conveyance claims asserted by individual creditors.

5. However, the Court also held that individual creditors' state law constructive fraudulent conveyance claims were automatically stayed by section 362. The Court explained that, the state law claims were stayed because an estate representative (*i.e.*, the litigation trustee) was asserting actual fraudulent conveyance claims targeting the same shareholder payments and unless and until the estate representative actually and completely abandoned its claims, the individual creditors lacked standing to bring their own fraudulent conveyance claims targeting the same transactions.

G. *Whyte v. Barclays Bank PLC (In re Semcog)*, 494 B.R. 196 (S.D.N.Y. 2013).[5]

1. State law fraudulent transfer claims brought by a litigation trust organized pursuant to a chapter 11 plan are impliedly preempted by a similar Bankruptcy Code safe harbor for swap transactions 11 U.S.C. § 564(g).

[5] The *Tribune* (see above) and *Whyte* decisions have been appealed to the Second Circuit. Case Nos. 13-2653 (2d. Cir.), ECF Nos. 192-93, 198; 13-3992 (2d Cir.), ECF Nos. 33-34, 37. The Lyondell Creditor Trust has filed an appearance as amicus counsel.

IX. Use Of Experts

A. *Tousa*

1. Daubert challenge to Plaintiffs' expert because he was not an appraiser, but rather a real estate professional, was rejected. *Tousa I*, at 823.

2. Lenders' "solvency opinion" was discounted(disregarded) because: (i) the "nationally recognized" firm was compensated on a contingency-fee basis pursuant to which the firm would earn a $2 million "premium" *only* upon a finding of solvency; (ii) the firm relied exclusively on projections provided by management; (iii) relied too heavily on management's *optimistic* projections; (iv) valuation was based on EBITDA multiples which experts for both Plaintiffs and Defendants agreed was inappropriate and unreliable given TOUSA's business. *Tousa I*, at 839 – 843.

3. The Court criticized one of Defendants' expert as "not credible"; having overstated his credentials – claiming no court had ever found his methodology to be unreliable – which the Court determined not to be true. *Tousa I*, at 832 – 837.

4. Court approved a "bottoms up" approach whereby Plaintiffs' expert looked at each individual community and how value would be affected in each. Defendants had taken a more "high level" approach. *Tousa I*, at 805-808.

5. The Court rejected the Defendants' argument that it was "inappropriate or impossible to determine the solvency of individual conveying subsidiaries because TOUSA and its subsidiaries collectively operated as a 'common

enterprise' . . . . [and] that this common enterprise should be examined on a consolidated basis." *Tousa I*, at 809. Holding instead that the statute "requires consideration of whether 'the debtor' was insolvent and, because each of the conveying subsidiaries is a separate and distinct 'debtor' each must be considered separately." *Tousa I*, at 809. Explained that unusual circumstances (alter ego) are necessary in order to view solvency on consolidated basis. *Tousa I*, at 861.

6. The *Tousa* Court had a laundry list of criticisms for Defendants' experts' approach, finding:

   a. Expert used wrong legal standard - used consolidated approach for REV. *Tousa I*, at 833-34.

   b. Experts' approach was "one size fits all". *Tousa I*, at 811.

   c. Experts wrongly called indirect benefits direct benefits. *Tousa I*, at 867.

   d. Defendants' experts contradicted each other. *Tousa I*, at 837-883.

   e. Defendants' experts never valued benefit. *Tousa I*, at 845.

   f. Expert improperly included goodwill in its insolvency analysis. *Tousa I*, at 831.

   g. Experts double counted trademarks. *Tousa I*, at 832.

B. *Tronox*

1. Insolvency – Failure To Adequately Address Contingent Liabilities (Environmental And Tort)

a. The parties' substantial dispute was over "the amount of Tronox's environmental and tort liabilities – which . . . is what this case is all about." *Tronox*, at 309.

b. While Plaintiffs and Defendants both engaged experts, only Plaintiffs' expert conducted a comprehensive valuation of Tronox's environmental liabilities. *Tronox*, at 310.

c. Defendants did not provide a comprehensive environmental liability analysis. Instead, Defendants' experts only offered criticisms of Plaintiffs' expert report. The Court characterized this as "a major failure of proof". *Tronox*, at 310-11.

d. Court indicated that Defendants' expert's extremely low estimate of future environmental liability (which was approximately the same amount that the newly-formed parent company had recently paid for remediation over a two-year period) did "not pass the common sense test." *Tronox*, at 311. See also *Johnson Elec. N. Am., Inc. v. Mabuchi Motor Am. Corp.*, 103 F.Supp. 2d 268 (S.D.N.Y. 2000)(noting that "(i)n assessing the reliability of an expert opinion, a resort to common sense is not inappropriate").

e. Court accepted the low end valuation range of Plaintiffs' expert for future environmental liabilities. *Tronox*, at 314.

f. Court noted that, once again, Defendants' expert did not provide any independent analysis of tort claims and instead limited his testimony to a critique of Plaintiffs' expert report. *Tronox*, at 314.

g. The Court explained that Defendants' experts' testimony, that no tort liability existed for future creosote claims even though there were at least 9,450 pending claims, "wholly undermined his credibility". *Tronox*, at 315.

h. Finding Plaintiffs' experts more reliable with regard to tort claims, the Court once again essentially adopted the low range of Plaintiffs' experts' figures. *Tronox*, at 315.

2. Like *Tousa*, the *Tronox* Court had a list of expert complaints:

a. Expert's use of accounting reserves was not useful. *Tronox,* at 310.

b. Experts blindly relied on management projections. *Tronox,* at 317.

c. Used Tronox's inflated "sell-side" projections. *Tronox*, at 316.

d. Experts' "comparables" analysis had flawed comparable companies and projections. *Tronox*, at 317-20.

e. Failed to recognize lack of adequate capitalization because Tronox had no ability to raise capital due to environmental claims. *Tronox*, at 320-3.

3. General Credibility

a. No matter how qualified your expert is, extensive background checks are critical. While the *Tronox* Court qualified Defendants' experts as expert witnesses and acknowledged that they had spent a good part of their career in court testifying on environmental matters, the Court noted, in a footnote, that "[i]t is not surprising

> that during the course of his long career, some courts have accepted his opinions and others have rejected them. The vehemence with which some courts have spoken is, however, relevant. One questioned his opinions as 'naked guesses' or 'far too speculative' and having 'no firm grounding in science.' . . . . Another judge rejected his responses in answer to the Court's questions as 'rank speculation,' concluding, '[t]here is simply no evidence to support [his] view,' and rejected [such expert's] 'suppositions . . . as unfounded and lacking all credibility.'" *Tronox*, at 310 and FN 95 (internal citations omitted).

X. Impact of *Stern v. Marshall* and its Progeny

A. In *Stern v. Marshall*, 564 U.S. ___, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011), the Supreme Court recognized that although the Bankruptcy Court had statutory authority to address "core" matters, and to enter final judgments under 28 U.S.C. § 157(b)(2), it did not, however, have constitutional authority to do so. The Supreme Court concluded that the counter-claim in question involved private rather than public rights and, therefore, Congress could not assign jurisdiction to an Article I Court (Bankruptcy), but rather such rights needed to be adjudicated by an Article III Court (District Court). Although the Supreme Court suggested that its holding was a narrow one and it would not meaningfully affect the division of labor under 28 U.S.C. § 157, the decision has nevertheless spawned a plethora of new matters and ones on appeal; on one of which the Supreme Court

heard oral arguments in January 2014 which may be decided by the time of this presentation. *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency, Inc.*), 702 F.3d 553 (9th Cir. 2012).

B. The Circuit Court in *Bellingham* found that fraudulent transfer claims brought against a creditor who did not file a claim could result in a final judgment by the Bankruptcy Court. This conclusion was based on a finding of waiver; that the Defendant had not raised the lack of jurisdiction until the appeal of the judgment. In so holding, the Ninth Circuit rejected other courts' findings that fraudulent transfer claims under the Bankruptcy Code (section 548) were not part of claims which "flow from a federal statutory scheme" and thus fall under a public rights exception to an Article III restriction. The Court held that the right to an Article III ruling in this fraudulent transfer context was personal rather than structural and, thus, could be waived. This conclusion runs directly afoul, however, of the Sixth Circuit holding in *Waldman v. Stone (In re Stone*), 698 F.3d 910, 914 (6th Cir. 2012) cert denied 2013 U.S. LEXIS 2333 (Mar. 18, 2013).

C. In *Stone,* state law fraudulent transfer claims were at issue, resulting in a final judgment against the Defendant for $3,000,000. Only on appeal to the Sixth Circuit did the Defendant challenge the Bankruptcy Court's jurisdiction. While consideration of the fraudulent transfer judgment violated Article III, the Court found that claims against Defendant implicating allowance of Plaintiff's claims based upon fraud theories could be finally adjudicated by the Bankruptcy Court. The Court further found that the Article III guarantees were structural and not

personal and a violation could not be remedied by a claim of waiver notwithstanding the lateness of the defendant's raising of the claim.

D. The Seventh Circuit has aligned itself with the Sixth Circuit on this issue in *Wellness International Network v. Sharif (In re Sharif),* 727 F.3d 751 (7th Cir. 2013). The *Sharif* case involved claims of alter ego. The Court did not determine whether such claims were core or non-core, suggesting that only if they are non-core can the Bankruptcy Court make proposed findings of fact and conclusions of law to the District Court – no such similar provision being in place with respect to core claims. The *Stone* Court, to the contrary, suggested that such recommendation was available even in a core matter. *Sharif*, at 761.

E. In *Global Technovations, supra*, the Sixth Circuit found that where the determination of fraudulent transfer was necessary in order to rule on allowability of a claim, the Court could enter a final order, including, findings (good faith) that were not strictly necessary in order to disallow claim. *Global Technovations*, at 722-723.

XI. Statute Of Limitations

A. Plaintiffs in *Tronox* were able to obtain longer statute of limitations by using section 544(b). Although activities commenced in 2002, the Court found that the oil and gas transfer was not complete until 2005, within Oklahoma's four (4) year statute. *Tronox,* at 267. No harm was realized until oil and gas assets were permanently removed. *Tronox,* at 268. Plans to transfer must be viewed as a whole, not in steps. *Tronox,* at 268. The involvement of the United States and its

similar claims under the Fair Debt Collection Practices Act ("FDCPA") allowed the Court to find a six (6) year look back (while recognizing and distinguishing other courts' conclusions that the FDCPA was not applicable law under section 544(b)).

XII. Savings Clause[6]

A. "Savings clauses" will not necessarily save an otherwise fraudulent transfer because:

1. Viewed savings clause as an *ipso facto* clause – therefore not enforceable. *Tousa I*, at 863.

2. Where entities are insolvent and received nothing – liens can't be enforced at all. *Tousa I*, at 863.

3. An effort to contract around "core" provision of Bankruptcy Code, not enforceable (what about section 546(e) "work around"). *Tousa I*, at 863 – 864.

4. They make a contract inherently indefinite and, therefore, contract is unenforceable. *Tousa I*, at 865.

[6] Savings clauses are designed to prevent upstream guarantees of a loan (and the liens on the guarantors assets that are given to support the upstream guarantees) from being avoided as constructively fraudulent under state law or bankruptcy law by limiting the amount recoverable under the guarantee to an amount that would not render the guarantee constructively fraudulent.

Chapter 17

Fraud and the Bankruptcy Code

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INTRODUCTION

President George W. Bush commented when signing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Bankruptcy Abuse Act") that, in part, this new law was designed to stop those who "try to commit fraud" and to "clamp down on bankruptcy mills" that advise abusers on how to "game the system."[1] The United States Bankruptcy Code (the "Bankruptcy Code") and related statutes have historically included numerous devices for punishment and prevention of fraud. The Bankruptcy Abuse Act added provisions to address how claims of fraud may be treated in bankruptcy as well as expanded liability for fraud in the context of a bankruptcy filing. Because bankruptcy often is used as a device to escape liability, it is critical to understand its workings when seeking recompense for fraudulent acts. This chapter discusses and analyzes both new and historical provisions of the Bankruptcy Code that are designed to identify and prevent fraud.

There is a perception, in the mind of the general public, that many debtors are abusing the bankruptcy process through criminally fraudulent activity. Evidently this perception is shared by both the Unites States Congress, which in 2005 passed the Bankruptcy Abuse Act, and by President Bush, who signed the act into law. The Bankruptcy Abuse Act represented government's attempt to eliminate a perceived abuse of the Bankruptcy Code, fraudulent or otherwise.[2]

In the public's mind, corporate "crooks" are abusing the bankruptcy laws at the expense of innocent creditors, investors, employees, and retirees. This belief has been fueled by the media coverage of recent bankruptcy filings of several large, billion-dollar corporations, including Enron and WorldCom.

This intense media focus and the unfortunate and dire consequences of these large corporate bankruptcy cases have fostered the public's negative perception of both corporate America and the bankruptcy process. "Enron-type" bankruptcies and the attendant criminal prosecutions provide the public, which is largely uninformed as to the intricacies of bankruptcy fraud and the bankruptcy process in general, with the impression that abuses are rampant and that the bankruptcy courts protect the perpetrators of bad acts.

In 2001, "Enron ranked seventh on the Fortune 500 list of America's largest corporations in 2001, and was, by all appearances, an immensely successful and profitable company."[3] By

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December 2001, however, Enron had dramatically and quite unexpectedly filed for bankruptcy protection. How could a billion-dollar, publicly traded corporation, which showed a prosperous balance sheet, be reduced to bankruptcy in less than one year? During the bankruptcy case, it was revealed that Enron had concealed tens of billions of dollars in debt through the use of "off–balance sheet" partnerships and other accounting irregularities.[4] The Enron bankruptcy had a devastating effect on countless groups of people, including the company's creditors, shareholders, and employees (whose retirement plans consisted largely of Enron stock, which was rendered worthless).

What impact did Enron's bankruptcy case have on any claims against Enron of fraud? Fraud claims against corporations in bankruptcy do not receive preferred treatment over general trade claims. Presumably, without a bankruptcy filing, any value in Enron's business and assets may have been lost to the detriment of various creditor groups. The public may have been left with the impression that somehow a bankruptcy filing is a device used to protect wrongful acts. Bankruptcy, however, does not facilitate fraud. In fact, it protects against a "feeding frenzy" on a fixed asset pool available to pay claims. It may also make it easier to recover damages due to fraud.

As provided in the Bankruptcy Code, bankruptcy proceedings can be in the form of a reorganization for either businesses or individuals (Chapter 11), a repayment plan for individuals limited by debt and asset ceilings (Chapter 13), or a straight liquidation of nonexempt assets for businesses or individuals (Chapter 7). Each of these chapters incorporates various provisions relating to acts of fraud committed both prior to and in conjunction with the bankruptcy filing.

Bankruptcy is often thought of as a device to escape or reduce one's financial obligations, and in some instances this view is accurate. The Bankruptcy Code, however, also enhances the prospect of recovery for victims of fraud, while substantially limiting the ability of debtors to discharge liability for fraudulent conduct. The Bankruptcy Code affects perpetrators, beneficiaries, and victims of fraudulent acts that occur prior to the commencement of bankruptcy proceedings (i.e., common law and statutory fraud). Related statutes also create their own codified construct for fraudulent acts undertaken in connection with an actual bankruptcy proceeding.

While various types of fraud will be discussed, this chapter is not intended to describe or define all types of fraud. Fraud is a state or federal law cause of action, and only in limited circumstances is it unique to the Bankruptcy Code. This chapter includes a review of how the Bankruptcy Code may permit perpetrators of fraudulent acts to escape from liability and what steps can be taken to prevent such an outcome. Fraud, as a part of actual bankruptcy proceedings, is also explored so as to illuminate the traps, including criminal statutes, set for those who use the Bankruptcy Code in a fraudulent manner. The Bankruptcy Code further creates vehicles to enhance the opportunities to pursue and obtain redress for fraud. Additionally, the recent amendments to the Bankruptcy Code, through the Bankruptcy Abuse Act, are addressed, including the increased scope of the law as it relates to a larger potential population of "bad" actors and "bad" acts. Finally, available alternate remedies for fraud actions against certain third parties are reviewed and discussed.

BANKRUPTCY REFUGE FOR FRAUDULENT ACTORS

Once fraud has occurred, the next logical step is to pursue the fraudulent party to recover damages suffered as a result of the fraud. There are a number of avenues available to creditors that have been defrauded. There are, however, also steps that individuals and businesses can

take to frustrate collection efforts. Creditors need to be aware of what debtors can and cannot legally do to frustrate remedial efforts.

Frequently, in an attempt to avoid their financial responsibility, perpetrators of fraud will file for bankruptcy protection. For actions based on fraud committed outside of a bankruptcy proceeding, however, only certain limited benefits are available in bankruptcy to fraudulent actors. Despite what may be portrayed in the media, or by legislators, the Bankruptcy Code has traditionally offered less protection to perpetrators of fraud than to other debtors.

Discharge

Bankruptcy is designed to permit debtors, to one degree or another, to begin their financial life anew. Central to the goal of a "fresh start" for debtors through bankruptcy is the concept of discharge. By filing for bankruptcy protection under Chapter 7 of the Bankruptcy Code, an individual debtor (as opposed to a corporate debtor) can obtain a discharge of most debts incurred prior to the bankruptcy filing. A discharge in bankruptcy relieves an individual debtor from all debts that arose before the petition date, regardless of whether a proof of claim based on any such debt has been filed.[5]

Only debtors who are individuals may obtain a discharge.[6] A corporation is, however, effectively discharged once all of its assets have been distributed through a Chapter 7 liquidation. At that point, there is no remaining ability to collect from the corporation. Additionally, if the corporation is in a Chapter 11 reorganization proceeding and is able to confirm a plan, the corporate debtor would be discharged as to liability for any debts that arose prior to confirmation.[7] Individual debtors in a Chapter 13 bankruptcy are also entitled to a discharge once their repayment plans are consummated.[8]

No Discharge for Fraud. Despite the availability of a discharge, the Bankruptcy Code provides no shelter to an individual that has committed fraud or is liable to a creditor for fraud. While claims of fraud enjoy no greater "priority" as against other claims, they may be treated more favorably as they are eligible to survive the bankruptcy. The Bankruptcy Code provides specific exceptions to discharge for debtors that have acted fraudulently. Specifically, the Bankruptcy Code contains two Sections pursuant to which a debtor that has committed fraud can be denied a discharge. Under Section 727, a debtor can be denied a discharge as to all of his or her debts. Section 523 precludes the discharge of specific debts, including those arising from fraud.

- 11 U.S.C. § 727(a)(2)

  Section 727(a)(2) of the Bankruptcy Code provides that an individual debtor will not be granted a discharge if the debtor acted fraudulently during the bankruptcy case or within one year before the petition date.[9] Under this Section, if applicable, the debtor would be denied a discharge as to *all* of his or her debts. Specifically, Section 727(a)(2) provides that the court shall not grant the debtor a discharge if:

  > (2) the debtor, with intent to hinder, delay or defraud has transferred, removed, destroyed, mutilated or concealed—
  >
  > (A) property of the debtor, within one year before the date of the filing of the petition; or
  >
  > (B) property of the estate, after the date of the filing of the petition.

  Individual debtors who abuse the bankruptcy process by committing fraud while the bankruptcy case is pending will not receive the potential benefit from filing bankruptcy (i.e.,

a discharge of prefiling or prepetition debts). Those individual debtors who have fraudulently transferred property belonging to the debtor prior to the bankruptcy filing will be similarly disadvantaged. In the case of *In re Womble,*[10] the debtor was denied a discharge based on his fraudulent transfer or concealment of assets prior to filing bankruptcy. Specifically, on the eve of bankruptcy, Womble transferred approximately $72,000 into closely held corporate entities purportedly for grazing rights for cattle owned by Womble.

In denying discharge, the court looked at several factors when determining if the money transferred was for a legitimate purpose, including whether: (1) the transfer was pursuant to a standard business practice; (2) the transfer was an arm's-length transaction; (3) the debtor transferred the funds voluntarily, or whether the situation effectively forced the transfer upon the debtor; and (4) the debtor received proper consideration for the transfer. The debtor in *Womble* maintained no records to substantiate his claim that the transfer was to pay for grazing rights. The transfer was not at arm's length, and the debtor was in dire financial condition at the time of the transfer. The debtor also introduced no evidence that he was required to pay the closely held entities (e.g., invoices to the debtor, bills that such entities had to pay for expenses associated with grazing, or evidence of consideration). As a result, the court denied the debtor a discharge pursuant to Section 727(a)(2).

A denial of discharge precludes release of all of the debtor's prepetition debts, and a creditor can pursue the prepetition obligations after discharge is denied. The creditor, however, can only seek satisfaction from nonexempt assets.[11]

- 11 U.S.C. § 727(a)(3)

  A debtor can also be denied a discharge if the debtor has concealed or destroyed financial records. Specifically, Section 727(a)(3) of the Bankruptcy Code provides that the court shall not grant the debtor a discharge if:

  > (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case.

  A debtor was denied a discharge pursuant to Section 727(a)(3) in the case of *In re Vetri.*[12] In *Vetri,* the debtor was a principal in nine corporations, owning and operating restaurants located in shopping malls throughout the United States. The debtor was unable to identify the location of the corporations' business records and claimed the records may either be at his parents' houses in Pennsylvania or Florida, or the records may have been lost when his home was burglarized and vandalized in 1987. In the end, the debtor failed to produce the records.

  The only records the debtor did produce were bank statements, canceled checks, and federal income tax forms. The debtor did not, however, provide any records relevant to his income for the period during which the bulk of large deposits and withdrawals occurred. The court held that due to the debtor's unjustified failure to keep adequate books and records from which his financial condition could be ascertained, the debtor should be denied a discharge under Section 727(a)(3).

- 11 U.S.C. § 523(a)(2)

  Pursuant to Section 523 of the Bankruptcy Code, certain specific debts can be found to be nondischargeable, even though the debtor might be entitled to a general discharge of prepetition debts. One such exception to discharge under Section 523(a) is for debts owed

by the debtor resulting from fraud.[13] Simply put, if a debtor defrauds a creditor, the debtor will not be able to use the Bankruptcy Code to discharge this specific debt, even if the debtor is otherwise entitled to a discharge.

Specifically, Section 523(a)(2) provides:

> (a) A discharge under Section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive.

To prevail under the discharge exception for debts obtained through false pretenses or false representation,[14] the creditor must establish that: (1) the debtor obtained money from the creditor by making a false representation or a false pretense; (2) the debtor knew that the representation or pretense was false when the debtor made it; (3) the debtor made the representation or pretense with intention to deceive the creditor; (4) the creditor relied on the false representation or pretense; and (5) the creditor suffered a loss as a proximate result.[15]

If it is established that the debt is nondischargeable, Section 523(a)(2) prevents the discharge of all liability arising from fraud, not merely amounts exacted from the creditor by the debtor.[16] In practical terms, this renders nondischargeable indebtedness arising from payments the creditor was required to make to third parties due to the debtor's fraud.[17] An objection to discharge pursuant to Section 523(a)(2) was illustrated in the case of *In re Ledet*.[18] In *Ledet,* the federal district court affirmed the bankruptcy court's decision to hold the debt to a bank nondischargeable under Section 523(a)(2). The bankruptcy court found that loans from the bank were obtained by false pretenses and false representations through the knowing submission of false borrowing reports to the bank for at least four contracts on which the debtor was not yet entitled to payment. The court also held that the bank justifiably relied on these false reports in extending credit.

The court relied on the testimony of the bank's loan officer and expert accountant that a valid receivable is one that has been earned under the terms of the contract and that reports which include receivables before the relevant account debtor could have been obligated for payment constituted clear misrepresentations.[19]

The court noted that nothing on the face of the borrowing base reports indicated that the supporting invoices were false and that the bank had performed a cursory examination of the reports without discovering any abnormality. Therefore, the court held the bank's reliance was justifiable. The debtor was denied discharge of the debt owed to the bank, pursuant to Section 523(a)(2).[20]

Nondischargeable debt based on fraud can also occur in the context of credit card transactions. In the case of *In re Van Dyke,*[21] the debtor opened a MasterCard account with a $5,000 credit limit with AT&T on December 30, 1995, at or about the time he became unemployed.

During the ensuing months of January and February 1996, the debtor obtained numerous cash advances on the credit card and quickly accumulated a debt of $2,900. The debtor became employed during the month of February, and his salary provided him with $1,800 per month. The debtor made minimal payments on the card, but he continued to increase the debt until finally reaching the $5,000 limit. At the time the debtor filed for bankruptcy, the credit card balance was $5,065.69.

The bankruptcy court stated that the general rule is that credit card charges made or cash advances received by individuals, who never intended to repay the charges, can be held to be nondischargeable under Section 523(a)(2). Fraudulent intent under this Section may be inferred from the surrounding circumstances. The court held that the charges the debtor incurred on the credit card during January and February were incurred while the debtor was clearly relying on the existence of future income. By the end of February, however, it was clear that the charges the debtor continued to incur were made while he was both already insolvent and lacking any reasonable belief of being able to repay his debts. The court further concluded that the debtor knew he was without such ability to repay the debt, and, as a result, he intended to deceive AT&T. The court decided, therefore, that the amount of the credit card debt incurred on and after March 1, 1996, was nondischargeable under Section 523(a)(2)(A).

Notably, Section 523(a)(2)(C) provides that certain debts are presumed to be non-dischargeable. Consumer debts for more than $500 for luxury goods and services that are incurred within ninety days of the bankruptcy filing are presumed nondischargeable.[22] Similarly, cash advances for more than $750 under an open ended credit plan within seventy days of the bankruptcy filing are also presumed nondischargeable.[23] Congress, in the Bankruptcy Abuse Act, amended the former, similar provisions of the Bankruptcy Code, extending the time limit and lowering the dollar amounts. These provisions indicate the disfavor that Congress has with those debts that are incurred so close to the filing of a bankruptcy. Indeed, Congress presumes these debts to be incurred on a fraudulent basis, thereby placing the burden on the debtor to prove that these debts were not incurred through fraud.

- 11 U.S.C. § 523(a)(4)

Section 523 also sets forth additional exceptions to discharge that involve, or may potentially involve, some element of fraud. Section 523(a)(4) provides an exception to discharge for debt from fraud or defalcation while acting in a fiduciary capacity.[24] Thus, for example, if a director incurs a debt to a creditor based on a breach of fiduciary duty claim, the director might not be able to use the Bankruptcy Code to discharge this debt.

Specifically, Section 523(a)(4) provides:

> (a) A discharge under Section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

In the case of *In re West,*[25] the debtor was a clergyman who advertised a program at the church to assist people with "financial difficulty," offering budget counseling and assistance with mortgage refinancing. The plaintiffs were an elderly couple who owned two inherited homes and struggled with their mortgage payments. At the first meeting, West requested a power of attorney from the plaintiffs, so that he could make arrangements for them to receive "favorable financing," and the couple agreed. West also convinced them to transfer the titles in their homes to the church in order to secure this "favorable financing."

West told them to make mortgage payments to the church in order to regain ownership and that those payments would be the same amount as before. The plaintiffs began receiving invoices for mortgage payments that were substantially higher than promised. The couple stopped making payments at the advice of an attorney, and the properties were foreclosed. The plaintiffs obtained a judgment against West for approximately $510,000.

West subsequently filed a Chapter 7 bankruptcy, and the plaintiffs sought to have West's debt to them determined to be nondischargeable under Section 523(a)(4) as a breach of fiduciary duty. A fiduciary duty is imposed upon an individual when he is in a position of confidence or trust whereby others rely on him to act on their behalf.[26] The court held that West acted in an agency and a fiduciary capacity pursuant to the granting of the power of attorney. West was in a position of dominance, for the plaintiffs were unsophisticated retirees who simply sought assistance in refinancing their homes. As opposed to Section 523(a)(2), a breach of fiduciary duty under Section 523(a)(4) does not require an actual intent or motive to commit fraud; rather, Section 523(a)(4) may also consider whether a party neglected his duties to act as a fiduciary for another.[27] West's actions constituted defalcation since he was acting in a fiduciary capacity pursuant to the power of attorney, and he did not discharge his fiduciary duty.

In a further effort to prevent perceived abuse of the bankruptcy laws and to limit protection for fraudulent acts, the Bankruptcy Abuse Act revised Chapter 13 of the Bankruptcy Code. Chapter 13 permits individuals with a regular income to propose a plan for repayment, as opposed to facing liquidation under Chapter 7. Under prior law, upon completion of all payments under a Chapter 13 plan, if debts based on fraud were addressed under the plan, any amounts of such claims remaining unpaid would be discharged. Pursuant to the latest amendments to Section 1328 of the Bankruptcy Code under the Bankruptcy Abuse Act, discharge for fraud claims articulated in Sections 523(a)(2) and (4) is no longer available.[28]

Both Section 523(a)(2)(A) and Section 523(a)(4) provide exceptions to discharge for the occurrence of fraud, yet each may be distinguished based on several factors. For example, Section 523(a)(2)(A) requires some actual reliance on the debtor's conduct, while Section 523(a)(4) does not require such reliance.[29] Most notably, however, Section 523(a)(2)(A) provides for a nondischarge for debts incurred through *actual* fraud. Section 523(a)(4) does not have such similar limiting language, instead providing simply for the nondischarge of fraud that occurs through a fiduciary relationship. Although the case law has not directly addressed this distinction, Section 523(a)(4) arguably precludes a discharge for debt incurred through actual *or* constructive fraud in a fiduciary relationship. This expansive definition of fraud covers both intentional fraud (actual) and fraud that may be implied based on the circumstances (constructive).

Preclusion of a discharge for fraud is not automatic. Procedurally, if a creditor seeks to have a debt determined to be nondischargeable, or seeks to have a general discharge denied, the creditor must commence an adversary proceeding against the debtor seeking such relief. An adversary proceeding is essentially a lawsuit brought in the Bankruptcy Court and in the larger bankruptcy case.

Exempt Assets

Even if a creditor is successful in having a debt determined to be nondischargeable, a debtor can still frustrate a creditor's collection efforts by taking full advantage of the legal right to

exempt certain property from being available to satisfy allowed creditor claims, even claims resulting from fraud. If property is exempt, it cannot be seized by creditors or liquidated in order to satisfy a debt owed. Thus, debtors who are subject to claims for fraud can still protect themselves to a limited degree by claiming certain assets to be exempt. Each state provides its own exemptions from collection for certain property, at least to the extent of certain dollar amounts.

The Bankruptcy Code also provides similar, but distinct, exemptions to those provided by state law. Like state exemptions, the Bankruptcy Code permits the debtor to retain the value of certain assets post–bankruptcy filing, free of any claims of unsecured (as opposed to lien or other secured) creditors. Section 522 is the principal Bankruptcy Code Section governing exemptions in bankruptcy cases.[30] It provides that debtors must file with their bankruptcy petitions lists of their exempt property. Section 522(b) also permits the use of either state or federal exemptions, unless the debtor's state does not allow the debtor to choose the federal exemptions.

States that prohibit debtors in bankruptcy from using the federal exemptions are often referred to as opt-out states. Debtors residing in opt-out states *must* utilize the exemptions that exist under the law of their particular state. Currently 34 states have opted out of the federal exemption system.[31] If a state has not opted out of the federal exemption system, then the debtor is free to choose either the exemptions provided for under Section 522(d) or under state law. Certain state statutes, such as Florida's, frequently provide greater and broader exemptions than the federal exemptions contained in Section 522(d). Debtors will frequently elect the state exemptions in these liberal states.

Federal or state exemptions can benefit the debtor and frustrate creditors. State exemptions are available to debtors in and out of bankruptcy to protect exempted assets from attachment by creditors. Federal exemptions under Section 522(d) are available only in bankruptcy and preclude those assets from being administered by a trustee for the benefit of creditors. Exemptions divide the estate into property reserved for the debtor, up to certain dollar limits, and property that will be available for the creditor's benefit. The exemptions assist the debtor in having some assets available after bankruptcy, so the person is not completely destitute.

Debtors often use pre–bankruptcy planning to take full advantage of the exemptions. To a limited degree, one may convert nonexempt property into exempt property prior to a bankruptcy filing. For instance, one could attempt to sell nonexempt property and use it to increase the amount of property owned in an exempt category. Further, and as discussed in more detail later, the debtor may attempt to move from one jurisdiction to another to take advantage of that jurisdiction's more favorable exemptions. The Bankruptcy Abuse Act, however, has substantially limited debtors' ability to undertake such bankruptcy planning by, among other things, placing lengthy time requirements on residency in certain jurisdictions before taking advantage of real estate exemptions.[32] Specifically, in order to take advantage of a particular state's exemptions, Section 522 (b)(3)(A) requires domicile for 730 days in a single state prior to filing. If such domicile does not exist for such period, then the domicile for the period of 180 days (or the longest period of such 180 days) prior to the 730-day period will govern which state's exemptions apply.[33]

Federal and State Exemptions

Section 522(d) provides the specific federal exemptions along with their corresponding dollar amounts.[34] State law exemptions may vary substantially from the federal exemptions. Whether a debtor should opt to use state law exemptions depends on the person's specific needs. For

instance, certain state exemptions, because of their broad protection, are very appealing to debtors. Debtors, therefore, must carefully examine their asset portfolios to determine which exemptions will provide them the maximum protection. Assuming that debtors are not in an opt-out state, they must choose one or the other; they cannot pick and choose from both federal and state law exemptions.[35] Michigan is an example of a state that has not opted out of the federal exemptions. Therefore, debtors in Michigan can choose either the state or federal exemptions, but not some combination of the two.

Michigan is typical in that it provides for greater monetary exemptions than the federal exemptions as to certain property. For example, wearing apparel and burial plots have unlimited exemptions.[36] Prior to January 2005, Michigan only provided a homestead exemption of $3,500 to individuals inside and outside of bankruptcy, as opposed to the $18,450 under the federal exemptions, thereby dissuading many from even considering the use of the Michigan exemptions.[37] Notably, however, Michigan statutory changes in January 2005 now provide different exemptions for debtors who file for bankruptcy. While debtors outside of bankruptcy may still only take advantage of the $3,500 homestead exemption, a debtor in bankruptcy may exempt up to $30,000 for his or her homestead and up to $45,000 if the individual is elderly or disabled. These exemptions coincide more closely with the federal bankruptcy exemptions.[38] The new Michigan homestead exemption remains subject to interpretation by the courts. For example, in *In re Lindstrom,*[39] the court held that joint debtors may only exempt $30,000 in their homestead; they cannot each use the exemption for an aggregate of $60,000.

In addition, Michigan does provide extensive homestead protection for those who own property as husband and wife in a tenancy by the entirety.[40] Real or personal property owned in a tenancy by the entirety may be exempt if the cotenant does not also file for bankruptcy.[41] Other states also provide much more lucrative exemptions than the federal exemptions. For example, Texas provides an overall personal property exemption of $30,000.[42] In West Virginia, debtors may exempt 80 percent of their wages.[43]

Aside from some of these more lucrative state exemptions, the majority of exemptions provided for under either state law or Section 522(d) of the Bankruptcy Code are for relatively small amounts and provide minimal assistance to debtors who are attempting to prevent a creditor's collection efforts. For example, under the federal exemptions, a debtor may protect only $2,950 in value of a motor vehicle[44] and only $9,850 in total for household furnishings and clothing.[45] It should be noted, however, that these amounts double in value for a household if both spouses file for bankruptcy protection.

The ability of debtors to perform bankruptcy "planning" depends to a large degree on the language of the exemptions. For example, Section 522(d)(10)(E) provides an exemption to the debtor for payments from a pension plan.[46] Additionally, the Bankruptcy Abuse Act amended the Bankruptcy Code to provide that a debtor can exempt retirement funds in a 401(k) plan.[47] While these two exemptions might provide protection for assets with substantial value, they provide only minimal assistance in bankruptcy planning because a debtor will not be able to immediately convert nonexempt assets into pension funds or a 401(k). Furthermore, there are various restrictions limiting the timing of the use of funds in these plans.

Pursuant to Section 522(c), unless the bankruptcy case is dismissed, property exempted under Section 522(d) cannot be used to satisfy any debts that arose prior to the petition date, other than certain limited exceptions such as tax, alimony, maintenance, and support claims that are exempt from discharge. Significantly, Section 522(c) does not provide an exception for debt that was found to be nondischargeable pursuant to Section 523(a)(2).

Property of the Estate. Certain property may not even be considered to be part of the bankruptcy estate. Like exempt property, this property may not be sold to satisfy the claims of creditors. Pursuant to Section 541(c)(2) of the Bankruptcy Code, a debtor's interest in a spendthrift trust is not considered property of the debtor's estate and cannot be used to satisfy claims. A spendthrift trust is "a trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed."[48] With a spendthrift trust, trust beneficiaries cannot voluntarily transfer their interest in the trust.[49] Because certain pension plans have a spendthrift trust provision, they may not be considered estate property. Similarly, because of the nature of Employee Retirement Income Security Act ("ERISA") qualified plans, providing that the benefits cannot be assigned or alienated, the U.S. Supreme Court has held a debtor's interest in an ERISA-qualified pension plan may be excluded from estate property pursuant to Section 541(c)(2).[50]

Homestead Exemption. One exemption that does provide a great deal of benefit to debtors is the homestead exemption. A homestead exemption allows debtors to shield from creditors, at least in part, the equity interest debtors have in their residences. The right of a homestead exemption is available pursuant to the law of many states and can be utilized in connection with a bankruptcy filing. A federal bankruptcy homestead exemption is available, but it is significantly more limited in comparison to some of the state homestead exemptions.[51]

Yet although some states have very favorable homestead exemptions, these favorable exemptions may now be limited by the revised Bankruptcy Code, as discussed later. For example, debtors who establish residences in Florida can shield from their creditors all of their equity in their homes, subject to certain minimal limitations. Article X, Section 4 of the Florida Constitution prevents an attempt to seize a Florida homestead to satisfy the claims of a creditor.[52] While the Florida homestead exemption is extremely broad, the Florida Constitution provides three exceptions to this exemption: (1) for taxes owed by the homesteader; (2) for obligations incurred by the owner which created the lien on the property by consent (i.e., a home mortgage); and (3) for claims of laborers and material men who contributed to the repair and improvement of the homestead.[53]

Despite these exceptions to the exemption, the liberal provisions of Florida's homestead exemption have been perceived as a source of abuse. The Florida homestead exemption had permitted debtors to protect the homestead even if it was acquired on the eve of, or immediately after, a judgment or if the debtor only recently obtained Florida residency. The ability to exempt the homestead in Florida was available even if a debtor's claims were based on fraud. In theory, this permitted a debtor who had committed fraud to liquidate her assets, take the proceeds, and move to Florida. If she invested those proceeds in an expensive house and filed for bankruptcy protection, she essentially protected all of her assets. This is commonly referred to as the mansion loophole,[54] and it can provide a safe haven for fraudulent actors.

The ramifications of the mansion loophole are illustrated in the litigation between Kevin Adell ("Adell") and John Richards Homes Building Co., LLC ("JRH"). The dispute between Adell and JRH included litigation in two states, Michigan and Florida, and involved fraud, dischargeability, and the Florida homestead exemption.

The Adell-JRH dispute began as a civil action in the Michigan state courts based on alleged breaches of a contract for the construction of a "high-end" home. Subsequently, Adell filed an involuntary bankruptcy petition (the "Involuntary Bankruptcy Case") against JRH in the Bankruptcy Court for the Eastern District of Michigan (the "Michigan Bankruptcy Court"), asserting claims arising under the contract.

The Involuntary Bankruptcy Case was defended by JRH, which sought dismissal and compensatory and punitive damages, based on a "bad faith" filing under Section 303(i) of the Bankruptcy Code.[55] On July 15, 2002, the Michigan Bankruptcy Court dismissed the Involuntary Bankruptcy Case and, thereafter, on April 25, 2003, awarded JRH compensatory damages in the amount of $4,100,000, punitive damages in the amount of $2,000,000, and attorneys' fees and costs in the amount of $313,230.68, plus interest at the statutory rate (the "Sanctions Order").[56]

Following entry of the Sanctions Order, Adell liquidated certain of his assets and moved to Florida. Specifically, Adell sold 13 vintage cars for $536,000, cashed in treasury bills in the amount of $1,700,000, withdrew $300,000 from his checking account, and wired all of these funds to his attorney in Florida.[57] Adell arrived in Florida on May 5, 2003, and began looking to purchase a home. Immediately upon his arrival, Adell took steps to establish his residency in Florida, including registering to vote, registering his car, and obtaining a fishing license.[58] On May 7, 2003, Adell signed a contract to purchase a residence in Naples, Florida, for $2,800,000. The purchase of the Florida residence closed on May 8, 2003.[59]

Following the purchase of the Florida residence, Adell filed a declaratory complaint in the Florida state court, seeking a determination that the Florida residence was entitled to the homestead exemption granted by the Florida Constitution.[60] JRH was able to get the complaint removed to the Michigan Bankruptcy Court. On September 17, 2003, the Michigan Bankruptcy Court entered an order (the "Homestead Order") providing that the Florida residence did not qualify for the Florida homestead exemption because (1) the Florida homestead exemption is trumped by Section 303(i) of the Bankruptcy Code (providing for sanctions for filing an involuntary petition), and (2) Adell was not a bona fide resident of Florida.[61]

Based on the Homestead Order, JRH was entitled to foreclose on the Florida residence. Adell then filed a bankruptcy petition under Chapter 11 on November 14, 2003, in the Bankruptcy Court for the Middle District of Florida (the "Florida Bankruptcy Court") immediately triggering the automatic stay provision of Section 362 of the Bankruptcy Code and preventing any foreclosure action by JRH.[62] Despite the bankruptcy filing, JRH contended that Adell's right to claim the Florida residence as a homestead had already been resolved by the Michigan Bankruptcy Court. Notwithstanding the Michigan Bankruptcy Court's Order, the Florida Bankruptcy Court held that Adell was entitled to a homestead exemption for his Florida residence.[63]

The Florida Bankruptcy Court noted that the purpose of Bankruptcy Code Section 303(i) is to compensate an entity that suffered damages as a result of an involuntary petition that had been improperly filed.[64] The Florida Bankruptcy Court reasoned that an award pursuant to Section 303(i) was similar to any other type of money judgment entered in a civil action based on an intentional tort.[65] The Florida Bankruptcy Court stated that such a judgment would not trump the homestead exemption under Florida law. While the Florida Bankruptcy Court noted that the Florida homestead exemption had been preempted by Section 1955(d) of Title 18 of the United States Code relating to a gambling forfeiture,[66] it did not believe that a preemption based on a federal gambling violation (or other criminal violations such as federal drug charges) should be applied in connection with a sanction order. It reasoned that the Sanctions Order was not akin to a violation of a criminal statute. The Florida Bankruptcy Court held thereby that the issuance of the Sanctions Order did not preempt the Florida homestead exemption.[67]

In examining the results of the homestead exemption, the Florida Bankruptcy Court concluded that Adell was a Florida resident entitled to the homestead exemption. The Florida

Constitution requires satisfaction of these criteria in order to avail oneself of the Florida homestead exemption: "(1) the debtor is a 'natural person'; (2) the debtor is a Florida resident and has established that he made, or intended to make the homestead at issue, his or her permanent residence; (3) the debtor is the owner of the homestead; and (4) the property claimed as a homestead is not in excess of acreage permitted by the Florida Constitution i.e., one-half acre within the boundary of a municipality or one hundred sixty acres of contiguous land located in the unincorporated areas of the municipality."[68]

The Florida Bankruptcy Court held that Adell owned his Florida residence, resided and continued to reside in Florida, and developed a new business venture in Florida. Based on these and other factors, the court concluded that Adell had the intent to become a bona fide resident of Florida and as such was entitled to the Florida homestead exemption.[69]

The *Adell* case provides an illustration of the breadth of protection which laws such as the Florida homestead exemption provide. Through the Florida homestead exemption, Adell was able to legally prevent JRH's collection of indebtedness by converting nonexempt assets into exempt assets through the purchase of the Florida residence. Had Adell not availed himself of this option, the vintage cars, cash, treasury bills, and other nonexempt assets could all have been seized by JRH to satisfy the indebtedness he owed. The homestead exemption in Florida makes no distinction in protecting a debtor's property from claims arising in the ordinary course based on fraud. Importantly, this exemption will not permit perpetrators of fraud to protect proceeds obtained through fraud via the mansion loophole. [70]

In Adell's bankruptcy case, JRH, as alternative relief, sought to have the Florida Bankruptcy Court impose either a constructive trust or equitable lien on Adell's Florida residence. The court recognized that it had the power to impose such a lien or trust if the proceeds of fraud were used to purchase the homestead.[71] The Florida Bankruptcy Court declined, however, to apply either a constructive trust or equitable lien because there was no evidence that Adell had purchased the Florida residence with proceeds obtained by fraud. Specifically, the Florida Bankruptcy Court stated:

> This Court has no difficulty to accept the proposition that if it is established by competent proof that the debtor who is claiming the homestead exemption acquired the homestead by fraudulently obtained funds or by embezzlement, it is appropriate to impose an equitable lien and possibly, in the alternative, a constructive trust. However, the record in this case is totally devoid of any evidence that would warrant the conclusion that the Debtor in the instant case purchased his Naples, Florida residence with embezzled funds or obtained funds through fraud. For this reason none of these alternative remedies sought by JRH have any merit.[72]

While debtors who create the homestead as an attempt to avoid creditors may protect the homestead, they may not be entitled to a discharge. In the *Adell* bankruptcy case, JRH objected to both the dischargeability of the Sanctions Order debt as well as Adell's general discharge. The Florida Bankruptcy Court found that Adell was not entitled to a discharge pursuant to Section 727(a)(2)(A) of the Bankruptcy Code because the homestead was purchased with intent to hinder, delay, or defraud within one year of the date of the bankruptcy filing. The Florida Bankruptcy Court found that:

> The record in this case leaves no doubt that the Debtor converted nonexempt assets into exempt assets, namely his Naples, Florida, homestead; that the transfer took place within one year before the date of the filing of the petition; and, based on the circumstances and events surrounding the sudden move to Florida, the transfer was made with the intent to hinder, delay or defraud a creditor, JRH. While the Debtor's homestead exemption is protected by the Florida Constitution

and are [sic] not subject to attack under these circumstances. *Havoco of America, Ltd. v. Hill,* 790 So.2d 1018 (Fla. 2001), his discharge is vulnerable.[73]

Thus, while the Florida residence was exempt and protected from seizure, JRH could continue to pursue collection efforts against Adell's other nonexempt present and future assets. The homestead exemption is "designed to promote the stability and welfare of the state by encouraging property ownership and independence on the part of its citizens, but most importantly, by preserving a home where the family may be sheltered and live behind reach of economic misfortune."[74] Whether consistent with this purpose or not, the homestead exemption enables debtors to protect significant assets from being subject to creditor attacks and, importantly, can even do so where fraud exists and in the shadow of the creditor obtaining a judgment.

New Limitations on Homestead Exemption. Statutes like the Florida homestead exemption have resulted in changes to the Bankruptcy Code. Through the addition of Bankruptcy Code Sections 522(o), (p), and (q), the Bankruptcy Abuse Act has limited a debtor's ability to take advantage of state homestead exemptions.

Section 522(o) states that the value of a property claimed as a homestead must be reduced by the amount of value that was generated through disposition of nonexempt property, with the intent to hinder, delay, or defraud creditors, and made within 10 years before the bankruptcy was filed.[75] Essentially, a debtor must refrain from infusing into the homestead any proceeds of nonexempt assets disposed of for the purpose of frustrating creditors. Furthermore, a court may circumstantially infer that any prepetition asset transfers made within 10 years before the bankruptcy and that created homestead equity were made with the intent to hinder, delay, or defraud creditors.[76] For example, in one case, the bankruptcy court rejected a homestead claim after it was revealed that the debtor had sold his truck days before filing for bankruptcy and then applied the proceeds to his home equity line of credit.[77] The debtor would not have been able to exempt his truck, so he sold it and used the proceeds to pay down his home equity line of credit. Before this amendment, debtors could effectively conduct exemption planning by converting nonexempt assets to exempt assets. The Bankruptcy Code now prevents such conversion of assets from enhancing the homestead exemption.

Section 522(p) provides that a debtor may not exempt an interest in a homestead that was acquired within 1215 days (three years and four months) preceding the bankruptcy filing and that exceeds the aggregate amount of $125,000 in real or personal property that the debtor claims as a homestead exemption.[78] Congress specifically stated that it wants to require debtors to reside in a state for a certain period of time before that person can take advantage of that state's homestead exemptions. This has effectively frustrated debtors who might otherwise engage in bankruptcy planning and move to states like Florida simply to take advantage of the state's favorable homestead provisions.[79]

Like Section 522(o), Section 522(q) seeks to limit the homestead exemption in the circumstance of bad acts by the debtor. Section 522(q) provides that a debtor may not claim a homestead exemption in excess of $125,000 if:

(1) The debtor was convicted of a felony which demonstrates that the filing of the bankruptcy case was an abuse of the Bankruptcy Code; or

(2) The debtor owes a debt arising from

   (a) A violation of the federal or state securities laws

(b) Fraud in a fiduciary capacity or in connection with the purchase of registered securities; or

(c) Any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.[80]

These provisions seek to prevent the escape from debt for those individuals who have engaged in certain types of conduct that is wrongful, and, in some instances, criminal. Congress effectively deemed certain individuals to be less worthy of full bankruptcy protection and thus precluded their ability to take complete advantage of the Bankruptcy Code.

The impact of these amendments to the Bankruptcy Code remains in flux. One issue that has arisen is whether the $125,000 statutory homestead exemption cap of Section 522(p) (and, by extension, Section 522(q) as well) applies to debtors with homesteads located in states that have elected to opt out of the federal exemptions.

The breadth of the homestead cap was first addressed by the United States Bankruptcy Court in Arizona. Arizona, like Florida, is an opt-out state. In the case of *In re McNabb,*[81] the Arizona Bankruptcy Court determined that the $125,000 homestead exemption cap applies only to debtors who live in states that allow debtors in bankruptcy to utilize either state or federal exemptions.[82] The court in *McNabb* focused on the phrase "*as a result of electing* under subsection (b)(3)(A) to exempt property *under state or local law,* a debtor may not exempt . . . ";[83] and, therefore, the court concluded that these sections can apply only to debtors who live in states that allow election of either state or federal exemptions in bankruptcy cases.[84]

Since Arizona is an opt-out state, the court in *McNabb* concluded that Section 522(q)'s statutory cap did not apply. The Arizona Bankruptcy Court acknowledged that its interpretation would result in the homestead exemption cap being applicable in the only two states, Texas and Minnesota, that allow debtors to choose between federal and state exemptions and also allow homestead exemptions in excess of $125,000.[85]

Following the decision in *McNabb,* the same issue arose in Florida, another opt-out state. Contrary to the decision in *McNabb,* the United States Bankruptcy Court for the Southern District of Florida, in the case of *In re Kaplan,*[86] concluded that the $125,000 homestead exemption cap applied to all states, regardless of whether they have opted out of the federal system of exemptions.[87] The *Kaplan* court addressed the *McNabb* decision, finding that the decision was only supportable based on narrow rules of statutory construction.[88] The *Kaplan* court rejected such a construction and instead relied on the legislative intent of Section 522, finding that the legislative intent was for the homestead exemption cap to apply to all states.[89] The court recognized the confusing language in Section 522(p) and (q), which references an election under state or local law, but it also noted how highly unlikely it would be for Congress to codify law that would only apply to two states.[90]

Based on the decisions in *McNabb* and *Kaplan,* there is currently a split of authority as to whether the $125,000 homestead exemption cap applies to opt-out states. There are several reasons why other courts addressing the issue may be persuaded to follow *Kaplan.* First, Florida is the state most commonly associated with the homestead exemption and the mansion loophole. By default, therefore, the Florida court's opinion may have the most impact on any asset protection analysis. Second, the Florida court's opinion appears to be better reasoned in light of the legislative history evidencing the purpose and intent behind this provision in the Bankruptcy Abuse Act.

Importantly, the mansion loophole is affected only by the statutory cap if debtors file bankruptcy. Should debtors not file bankruptcy, then they would be entitled to avail themselves of

all debtor-friendly state laws including, in Florida, a homestead exemption in excess of $125,000. In this scenario, however, with no bankruptcy filing, other collection efforts would not be stayed.

New Deterrents to Fraudulent Actors

The Bankruptcy Abuse Act has imposed other procedural requirements on debtors in an attempt to limit manipulation by fraud within the bankruptcy system. The "honor system" has been discarded, and individual debtors are now required to submit copies of their tax returns and pay stubs with the bankruptcy petition. In connection with a bankruptcy case, a debtor is required to file a sworn statement containing an oath, under penalty of perjury, swearing to the authenticity of a statement of facts. Attorneys filing bankruptcy petitions are also now expressly required to make an effort to verify the accuracy of the debtor's sworn statement.

The Bankruptcy Abuse Act also provides a "means test" in order to determine if a debtor is eligible to file a Chapter 7 bankruptcy petition, such that only certain debtors in lower income levels are now able to file a Chapter 7 bankruptcy as opposed to a Chapter 13.[91] Debtors also must attend an approved financial management course in order to receive a discharge. Debtors who have the ability to do so will now be required to pay back at least a portion of their debts. Furthermore, the permissible time period for repeat bankruptcy filings has been increased from six years to eight years. The Bankruptcy Abuse Act is a further effort to ensure that the Bankruptcy Courts are not refuges for fraudulent actors.

BANKRUPTCY FRAUD

Dating back to the first American bankruptcy statute in 1800 and continuing through to the present day, Congress has enacted legislation that provides for criminal punishment to persons who abuse the bankruptcy process through fraud and falsification.[92] Violation of these statutes is commonly referred to as bankruptcy fraud. While these criminal statutes have been revised and expanded over time, the intent of the criminal statutes has remained consistent: Bankruptcy fraud interferes with the goals and purpose of the Bankruptcy Code and must be deterred. The current criminal statutes enacted by Congress to address bankruptcy fraud are found in Title 18, Sections 152 through 157 of the United States Code, and the types of acts that these statutes address are known as the bankruptcy crimes.[93] Also, as part of the Sarbanes-Oxley Act of 2002,[94] an additional statute dealing with obstruction of justice, in circumstances including bankruptcy, was added.[95]

The issue of bankruptcy fraud is increasingly becoming a hot topic. Some form of bankruptcy crime statute has been in existence for over 200 years. For the vast majority of that time period, however, prosecutions for bankruptcy crimes were rare. This is no longer the case.

Debtors and their attorneys, creditors of bankrupt debtors, the courts, and various federal law enforcement agencies, such as the United States Trustee's Office and the United States Department of Justice, have a strong interest in preserving, protecting, and defending the integrity of the bankruptcy system.[96] Over the past decade, the United States Department of Justice has placed an increased emphasis on the prosecution of persons committing bankruptcy fraud.[97] This fact, along with the U.S. sentencing guidelines (which govern sentencing of defendants convicted of bankruptcy crimes), has meant that persons who commit bankruptcy fraud are now frequently sentenced to prison.[98] No longer is bankruptcy fraud viewed as a semi-harmless white-collar crime. Bankruptcy fraud is a serious crime with serious consequences.

The bankruptcy crimes statutes identify several situations that can subject a person to significant consequences, including fines, imprisonment up to five years, or both. Importantly, the bankruptcy crimes not only apply to debtors but, with certain limited exceptions, also apply to any person committing one of the various prohibited acts. Although the vast majority of bankruptcy prosecutions focus on either the debtors or creditors, professionals advising the debtors, including attorneys, can face criminal prosecution as well.[99] Imposing a high level of scrutiny on debtors, creditors, and professionals helps to keep them honest, which ultimately deters illegal manipulation of the bankruptcy system and enhances the prospects for creditor recovery.

Concealment of Assets; False Oaths and Claims; Bribery—18 U.S.C. §§ 152–158

Introduction. The key bankruptcy crime statute for purposes of detecting and preventing fraudulent conduct in connection with a bankruptcy case is Section 152 of Title 18 of the United States Code ("U.S.C."). Section 152 is a broad provision "attempting to cover all of the possible methods by which a debtor . . . may attempt to defeat the Bankruptcy Act through any type of effort to keep assets from being equitably distributed among creditors."[100] Section 152 makes it a crime for a person to conceal assets,[101] provide a false oath or account,[102] make a false declaration,[103] file a false proof of claim,[104] destroy or conceal the debtor's financial records,[105] or give or accept a bribe in connection with a bankruptcy case.[106] Each of these actions, if not detected, would substantially interfere with the purposes and goals of the Bankruptcy Code by ultimately depleting recovery to creditors. These criminal acts are discussed next.

Section 152(1) Fraudulent Concealment. Section 152(1) makes it a criminal offense for a person to fraudulently conceal assets of the debtor's estate in connection with a bankruptcy case. Fraudulent concealment is the most commonly prosecuted bankruptcy crime.[107]

- *Disclosure of assets.* In addition to providing a fresh start to debtors, the Bankruptcy Code's intent is to provide a fair and equitable distribution of a debtor's assets to creditors.[108] In order to assure disclosure of the debtor's assets and liabilities to the court, any appointed trustee, and the creditors, the Bankruptcy Code and the Bankruptcy Rules impose certain obligations upon a debtor after filing for bankruptcy protection. The Bankruptcy Rules specifically require that every person who files bankruptcy must truthfully complete: a list of creditors; a schedule of all assets, liabilities, current income, and current expenditures; and a statement of financial affairs.[109] The Bankruptcy Rules also require every debtor to appear under oath at the beginning of each bankruptcy case and to answer questions about his or her financial affairs at the first meeting of creditors.[110] The debtor's disclosure requirement includes disclosure of *all* assets, even if their status is uncertain.[111] Failure to comply with the Bankruptcy Rules may constitute a violation of Section 152(1).

  Property of the debtor is defined in broad terms, and a debtor must disclose all assets, including equitable interests.[112] Disclosure of the debtor's equitable interests was discussed in *United States v. Moynagh.*[113] In *Moynagh,* the defendant maintained a power boat and a sailboat and subsequently transferred legal title to the boats to Marlin Boat Company, which was owned by the defendant's mother and son. Later the defendant paid off some of the debt and maintenance costs for the boats. When the defendant subsequently filed bankruptcy and filed his schedules of assets, he failed to list an interest in the boats. The

court held that even though legal title to the boats had been transferred to and registered in the name of Marlin Boat Company, the defendant retained an equitable interest in the boats because he still owed money pursuant to liens on the boats.[114] A failure to list that equitable interest can support a charge of concealment of assets. In this case the court concluded that there was sufficient evidence to establish the defendant had an equitable interest in the boats. Even assets that are considered exempt assets and not subject to administration by the debtor's estate, either pursuant to state law exemptions or the Bankruptcy Code, need to be disclosed.[115]

As in *Moynagh,* the Seventh Circuit in the case of *In the Matter of Kaiser*[116] reviewed whether the debtor retained an equitable interest in certain property and whether it was part of the bankruptcy estate.[117] In *Kaiser*, the shareholders of the debtor corporation owned land used by the debtor. The shareholders never leased or sold the land to the corporation, but the corporation paid the loans and real estate taxes on the land. Because of this seemingly dual ownership of the land, the court scrutinized whether the corporation truly owned the land or whether the individual shareholders owned it and were merely using taking advantage of bankruptcy laws.[118] The disclosure statement of the corporation stated that the land was an asset of the bankruptcy estate of the debtor corporation. This permitted the corporation to obtain an extension of credit during bankruptcy. The court held that the debtor corporation properly disclosed its equitable interest in the land, for it paid all expenses on the land and both the corporation and its shareholders held it out as property of the corporation. The debtor retained an equitable interest despite the fact that legal title was still in the individual's name and was never transferred to the debtor.[119]

While Section 152(1) aims to prevent the fraudulent subversion of the bankruptcy process by providing a specific statute making such fraudulent concealment of assets a criminal act, it is important to keep in mind that the statute criminalizes fraudulent concealment and not negligent disclosure. Thus, in order for a person to be in criminal violation of Section 152(1), it is necessary for the concealment to have been committed knowingly and fraudulently.[120]

- *Elements of fraudulent concealment.* The elements of fraudulent concealment of assets generally consist of:
  - The existence of a bankruptcy case;
  - Concealment of property of the debtor's estate; and
  - Concealment of the property knowingly and fraudulently with the intent to circumvent the bankruptcy process[121]

  In light of the criminal nature of the action, in order to convict a person of fraudulent concealment of assets, all of the above elements must be established beyond a reasonable doubt.
- *Existence of a bankruptcy case.* Of the preceding elements, the first is the simplest to prove. In order for a bankruptcy crime to have been committed, there must first be a pending bankruptcy case. Thus, a prosecution under Section 152(1) "clearly requires that bankruptcy proceedings have commenced, and proceeded sufficiently far for a Trustee, Marshall or other Court officer to have been appointed."[122] The remaining two elements, however, have proven more difficult to establish.
- *Concealment of property of the debtor's estate.* Before determining if an asset was concealed, courts must first establish that the asset in question was actually property of the

estate. Courts have broadly interpreted what qualifies as "property" and "assets."[123] Property and assets include all legal or equitable interests the debtor has in property existing on the date that the bankruptcy case is filed or that the debtor acquires after the commencement of the bankruptcy case. A broad definition of the terms "property" and "assets" is consistent with the stated purpose of providing a fair and equitable distribution of assets.

In connection with Section 152(1), the term "concealment" includes any act that hides the existence of property or assets belonging to the debtor's estate from persons entitled to know about such property or assets, including creditors, the court, and other interested parties.[124]

The element of concealment has been in this way defined:

> Concealment means, not only secreting, falsifying and mutilating . . . but also includes preventing discovery, fraudulently transferring or withholding knowledge or information required by law to be made known.
>
> . . . Clearly concealment means more than "secreting"; one does not have to put something in a hidden compartment, a safe, or a hole in the backyard in order to "conceal" it. It is enough that one "withholds knowledge," or "prevents disclosure or recognition."[125]

Concealment can take many shapes and forms. One particularly egregious case occurred in *United States v. Kubick*.[126] In *Kubick,* the defendant was a successful real estate developer in Anchorage, Alaska. Following the collapse of the Alaskan oil market in the mid-1980s, the value of Kubick's real estate holdings decreased, and he began to experience financial difficulties. As a result, Kubick conceived a plan whereby he would conceal his assets and attempt to discharge his debts through a bankruptcy proceeding.[127]

Kubick enlisted the assistance of various people, including family members, friends, accountants, and his attorneys, William Herron and Carol Birdwell. Kubick filed for Chapter 7 bankruptcy. Assets not disclosed in the bankruptcy case included $150,000 that was laundered through Herron's firm in anticipation of filing bankruptcy, a Range Rover that was purchased for $48,000 with money in Herron's trust account, his big-game trophy collection, jewelry, furs, buried money, and various other properties totaling a value in excess of $4.6 million. Kubick also failed to disclose his controlling interest in several corporations and partnerships that continued to hold or participate in various real estate developments in Alaska and Wyoming.

Kubick was criminally indicted for conspiracy to commit bankruptcy fraud, among other charges. Ultimately, Kubick pleaded guilty to one count of conspiracy to commit bankruptcy fraud and one count of conspiracy to impede and impair the IRS. The court sentenced Kubick to 58 months in prison.[128]

In addition to Kubick, his attorneys, Herron and Birdwell, were also indicted. Herron pleaded guilty to one count of conspiracy to commit bankruptcy fraud and was sentenced to 36 months in prison.[129] Herron appealed his sentence to the Ninth Circuit Court of Appeals. The court upheld Herron's sentence. On appeal, Herron contended that the court considered "non-fraudulent" conduct in determining the sentence. The court disagreed and noted that the $48,000 used to buy the Range Rover came from Herron's trust account and the $150,000 was wired from Herron to his attorneys in Anchorage, Alaska. The court determined that these matters were properly considered in determining Herron's sentence. Furthermore, the Ninth Circuit held that federal sentencing guidelines may be applied to bankruptcy proceedings and used to "increase the offense level of a defendant who conceals assets in violation of the bankruptcy process."[130]

While Kubick's conduct was particularly egregious, concealment can take a more subtle form, such as fraudulent accounting. This was evident in the case of *United States v. Turner*.[131] In *Turner*, the defendant owned most of the stock in and was employed by a car dealership. The dealership experienced financial difficulties and filed for bankruptcy under Chapter 11. Following the bankruptcy filing, the defendant sold a car to another dealership. The sale, however, was not recorded in the debtor's records.[132] After an investigation by the FBI, the defendant was indicted for fraudulently concealing assets in violation of Section 152. The court, in upholding the defendant's conviction, noted that possessing the proceeds from the sale of the car was not an element of the crime of concealment: "Turner's crime was not in selling the car, possessing the proceeds, or using the proceeds to pay debts, but rather in preventing the discovery, by the trustee or the corporate debtor, of what he had done with the money."[133]

Intentional undervaluing of assets can also amount to fraudulent concealment. In *United States v. Walker*,[134] the defendant and his wife filed for bankruptcy protection. In the bankruptcy case, the debtors' statement of financial affairs specifically undervalued their personal property by over $245,000.[135] The defendant was ultimately charged with fraudulent concealment of assets pursuant to Section 152 and pleaded guilty.

- *Knowing and fraudulent concealment.* In order for one to be guilty of a criminal violation, the perpetrator must act with *mens rea*, or a guilty mind. For the concealment to be criminal, it must be both knowing and fraudulent. As seen in the *Turner* case above, concealment means more than merely secreting assets. It is sufficient that a person withholds knowledge of an asset or prevents disclosure or recognition of an asset or fails to list several bank accounts.[136] Thus, Section 152 is not intended to punish inadvertent, innocent, or unknowing actions. Because the onus is broad for disclosure of assets, if a person is uncertain as to whether an asset should be disclosed, the debtor should err on the side of caution and report the asset.

  In addition to concealment, Section 152(1) also requires that the concealment is made fraudulently. A fraudulent act in this context requires a false representation of material fact made with knowledge of its falsity and with the intent to deceive.[137]

  The distinction between knowing and fraudulent concealment is illustrated in *United States v. Yasser*.[138] In Yasser, the defendant was employed by Crawfords, Inc. ("Crawfords"). Prior to Crawfords filing for bankruptcy, the defendant removed merchandise from Crawfords and sold portions of the merchandise.[139] After Crawfords filed bankruptcy, the defendant continued to retain either the merchandise or the proceeds of the sale of the merchandise.[140] Subsequently, the defendant was charged with and convicted of fraudulent concealment of Crawfords' assets.

  On appeal, the court overturned the defendant's conviction. The evidence indicated that while the defendant may have been familiar with the books and records of Crawfords, the defendant was not informed of the bankruptcy. The evidence indicated that the defendant was not aware of any bankruptcy proceeding until the commencement of the criminal action against him. In overturning the conviction, the court stated that with respect to fraudulent concealment, "the essence of the crime is knowingly and fraudulently to conceal from the receiver or trustee in bankruptcy. It must, therefore, appear that the defendant had actual knowledge of the existence of a receiver or trustee in bankruptcy or that he willfully closed his eyes to facts which made the existence of such an officer obvious."[141] The prosecution did not offer any evidence that the defendant knew of the existence of the bankruptcy case.[142]

Thus, the defendant lacked the requisite willful conduct necessary to establish fraudulent intent.

Section 152(7) Concealment in Contemplation of Bankruptcy. In addition to the prohibition against concealing of assets during a pending bankruptcy case, Section 152(7) criminalizes the concealment of assets in contemplation of filing bankruptcy. Specifically, Section 152(7) prohibits a person in either a personal capacity or as an agent or officer of a person or corporation, while contemplating filing bankruptcy, from fraudulently concealing or transferring their property with the intent to defeat the provisions of the Bankruptcy Code:

> The purpose of criminalizing a transfer or concealment of assets, if done with the requisite *mens rea*, and in contemplation of bankruptcy or to defeat the provisions of Title 11, is to prevent and punish efforts to circumvent the provisions of Title 11, including the "priorities among creditors . . . and the rule that claimants within a class share pro rata.[143]

The application of Section 152(7) was illustrated in the case of *United States v. Sabbeth.*[144] In *Sabbeth,* the defendant was the sole shareholder and president of Sabbeth Industries, Ltd. The defendant was also the landlord for the corporate headquarters and occasionally lent money to the corporation. The corporation filed for bankruptcy protection on December 28, 1990. The corporation owed the defendant approximately $2 million for past due obligations; however, this debt was subordinated to the indebtedness owed to the corporation's secured lender. The secured lender discovered that the defendant had been withdrawing money in the form of company checks in an amount exceeding $1 million, with approximately $750,000 of this amount having been withdrawn between June 1, 1990, and December 28, 1990.

The defendant claimed that the money he took from the corporation during the contemplation of bankruptcy did not violate Section 152(7), since the money was in satisfaction of antecedent debts. The court, nonetheless, held that the money was taken in contemplation of bankruptcy and for the purpose of receiving more money from the company than other creditors. It was, therefore, "property" of the corporation and taken in violation of Section 152(7). The court concluded that the receipt of each corporation check in payment of an antecedent debt was criminal at the moment of transfer.

Section 152(2) and (3) False Oath or Statement. Section 152 also makes it a crime to make a false oath[145] or a false statement[146] in connection with a bankruptcy proceeding. In prosecuting such a charge, four things must be established:

1. A bankruptcy case was in existence.
2. A false statement or oath was made.
3. The statement related to a material fact.
4. The statement was made knowingly and fraudulently.[147]

The threshold issue is a determination as to whether the oath or statement was false. A false statement is generally defined as "a statement or assertion which is known to be untrue when made or when used."[148] False statement prosecutions frequently involve the debtor's failure to disclose an interest in certain corporate assets, misrepresentation regarding the number of bank accounts, or a false statement concerning the highest bid for property[149] in connection with a bankruptcy sale.

The false statement also must be material. A false statement or oath with respect to a matter that is inconsequential to the bankruptcy proceeding would not violate the statute: "Materiality

does not require a showing that creditors are harmed by the false statements. Matters are material if pertinent to the extent and nature of the bankrupt's assets, including the history of a bankrupt's financial transactions."[150]

In the case *United States v. Center,*[151] the defendant was an attorney representing debtors in a Chapter 11 bankruptcy case and assisting them in preparing and filing their schedules of assets and liabilities. The defendant failed to list a debt owed to the debtor on the asset schedule.[152] After the defendant discovered that the asset had been omitted, the defendant did not take any action to notify the bankruptcy court of the omitted asset. Instead, the defendant had documents executed and book entries backdated for the purpose of creating a setoff.[153] At trial, the defendant was convicted of falsifying and making false entries in a document affecting or relating to the affairs of a debtor. The appellate court upheld his conviction.[154]

The court noted that "the purpose of [Section] 152 is to proscribe the concealment of a bankrupt's assets (with false book entries being one of the possible vehicles available to affect a concealment)."[155] In upholding the conviction, the court found that the book entry was fraudulent since it misrepresented the date of the transaction.[156]

Section 152(4) False Claims. Section 152(4) makes it a criminal offense for a person to knowingly and fraudulently file a false proof of claim against the debtor's estate. The elements for filing a false proof of claim under Section 152(4) are:

1. A bankruptcy case was in existence.
2. A proof of claim was willfully presented in the bankruptcy proceeding.
3. The proof of claim was false as to a material matter.
4. The defendant knew the proof of claim was false at the time it was made and thus made it knowingly and fraudulently.[157]

Good faith is a defense to a charge of filing a false proof of claim.[158] This bankruptcy crime is similar to the offenses prohibited by Sections 152(2) and (3), with the distinction that statements under the latter statutes are made under oath, while a false proof of claim can be criminal without the claim being made under oath.[159]

Section 152(6) Bribery. Section 152(6) essentially criminalizes bribery in the context of a bankruptcy proceeding. Section 152(6) prohibits a person connected with a bankruptcy proceeding from offering or accepting money or property in exchange for acting or forbearing to act in a bankruptcy case. Prosecutions under this act are extremely rare and as a result published cases are equally rare.[160] In *United States v. Weiss,*[161] the defendant attempted to obtain $500 by promising to refrain from bidding at the sale of debtor's assets. The defendant advised that if he were not paid the $500, he would attempt to outbid the other party.[162] The defendant was convicted of violating Section 152. The defendant attempted to argue that he did not violate the statute because his actions were only preparatory in nature and not an actual attempt to bribe. In essence, the court found that the defendant did exactly what he promised he would do if not paid the money, which was to bid on the assets.[163]

Section 152(5) Fraudulent Receipt of Debtor's Property. In addition to the prohibition against bribery contained in Section 152(6), Section 152(5) makes it a crime for a person to knowingly and fraudulently receive any material amount of property from a debtor after the filing of a bankruptcy proceeding.

Sections 152(8) and (9) Concealment, Destruction, and Withholding of Documents. Section 152 contemplates that wrongdoers, in an attempt to cover-up their fraudulent acts, will "destroy the evidence." Accordingly, Sections 152(8) and (9) make any attempt by a person to falsify, destroy, or withhold records of the debtors a separate criminal offense. In the case of *In the Matter of Orenduff,*[164] the court concluded that the debtor had access to certain records and did not reveal them to the trustee.[165] As a result, the court denied the debtor a discharge.[166]

Aiding and Abetting Notably, Section 152 punishes any "person" who commits one of the enumerated crimes in the statute. Thus, it is not only the debtor who can face criminal liability under Section 152, but also the professionals who assist the debtor, including the debtor's attorneys. In *United States v. Dolan,*[167] the debtor's attorney was convicted of aiding and abetting in the concealment of property from the bankruptcy estate. Gary Dolan, an attorney, represented David Anderson in several business litigation matters. On September 16, 1987, an involuntary Chapter 7 bankruptcy case was filed against Anderson.[168] Dolan represented Anderson in the case, which was converted to one under Chapter 11. Dolan also assisted Anderson in filing his schedules of assets and liabilities.[169] The schedules included several omissions, including the omission of Anderson's ownership of a Ferrari valued at $85,000.[170]

Also omitted was reference to a lawsuit filed by Anderson against Intermedics, Inc. during the bankruptcy case (the "Intermedics Lawsuit").[171] The Intermedics Lawsuit was filed during the course of the bankruptcy case. While Dolan was not the lead attorney, he was listed as additional counsel and was aware of the existence of the Intermedics Lawsuit.[172] A settlement was reached with Intermedics, Inc. whereby Anderson received two checks totaling approximately $1.9 million.[173] Dolan was aware of the settlement.[174] The settlement agreement also provided that Dolan was to receive $50,000 as a personal bonus.[175]

Despite knowledge of the existence of the settlement proceeds and the Ferrari, neither Dolan nor Anderson ever amended the schedules to include these items.[176] While Anderson amended the schedules in other respects, he failed to list either the Ferrari or the settlement proceeds.[177]

Dolan repeatedly told Anderson's creditors that Anderson was unable to pay them.[178] Dolan did not mention the ownership of the Ferrari or the receipt of the settlement proceeds during settlement negotiations with various creditors.[179] Specifically, at Dolan's trial, a number of attorneys testified that Dolan explicitly advised them that Anderson did not have sufficient funds to pay claims. This misrepresentation resulted in a creditor settling a $21,245.81 claim for $5,000. This creditor's attorney testified that if she had known of the existence of the settlement proceeds, she would not have settled for such a small amount.[180]

In upholding Dolan's conviction, the court noted that Dolan was aware of Anderson's ownership of the Ferrari and the $1.9 million settlement proceeds, and Dolan signed an acknowledgment that authorized the payment of the settlement proceeds directly to Dolan. Based on Dolan's knowledge and his failure to disclose the existence of the assets, the court concluded that Dolan's actions were criminal.

An attorney was similarly convicted of aiding and abetting her client's fraudulent concealment in *United States v. Webster:*[181] Steven Deiss purchased a tavern and retained the services of attorney Leslie Webster to incorporate his ownership of the business.[182] The attorney advised Deiss and his wife to consider filing for bankruptcy in order to discharge their debts.[183] The attorney incorporated a new entity that acquired the tavern and its assets.[184] Following the incorporation of the tavern, Deiss and his wife followed the defendant's advice and filed for Chapter 7 bankruptcy. The defendant represented the Deisses in the bankruptcy case and in this capacity drafted the debtors' bankruptcy schedules and statement of financial affairs.[185]

The schedules and statement of financial affairs contained two significant false representations. First, the Deisses' schedules stated that Steven Deiss had voluntarily surrendered ownership of the tavern in exchange for release of an unpaid balance of a land contract.[186] Deiss failed to identify in the schedules that his tavern had been conveyed to a corporation on the eve of the bankruptcy filing.[187] Additionally, on the debtors' list of personal property, the defendant failed to report any stock ownership Deiss had in the new corporation and represented to the bankruptcy trustee that this was a "no asset case."[188] Approximately one year after Deiss was discharged, an investigation by an insurance company regarding a fire at the tavern uncovered the debtors' bankruptcy filing, which indicated that Deiss had no interest in the tavern. Deiss was subsequently charged with fraudulent concealment of assets to which he pleaded guilty. Deiss's cooperation with the government investigation led to the defendant, his attorney, being indicted and convicted on the charge of aiding and abetting the fraudulent concealment of assets.[189] On appeal, the court noted that there was ample evidence to convict Deiss including participation in the incorporation; backdating stock certificates; and with this knowledge, preparing the schedules and statement of financial affairs of the debtor.[190]

The reasoning of these cases may also apply to other professionals, such as accountants. Consequently, no group of professionals is immune to the provisions of Section 152.

Embezzlement—18 U.S.C. § 153

Title 18, Section 153 of the United States Code makes it a criminal offense for a person to knowingly and fraudulently misappropriate, for his own use, embezzle, spend, or transfer property of the debtor's estate. Additionally, Section 153 makes it a criminal offense for a person to knowingly and fraudulently secrete and destroy any documents belonging to the debtor's estate.

Section 153 is not as far reaching as Section 152, since Section 153 applies only to persons in a fiduciary relationship with respect to the debtor's assets and property. A person in a fiduciary relationship has an obligation of trust with respect to the assets of another. Section 153 also applies to persons participating in the administration of the bankruptcy estate as a trustee, custodian, marshal, or an attorney. Courts have defined a "custodian" under Section 153 as a person other than a trustee or receiver (but including the trustee's attorney) who takes custody of any property belonging to a bankrupt estate.[191] This offense carries a penalty of up to five years imprisonment and/or a fine.

The bankruptcy crimes of "fraudulent concealment" and "embezzlement" are similar but distinct criminal offenses. Oftentimes related activities may give rise to violations of both statutes. Such was the scenario in the case of *United States v. Atiyeh*.[192]

Atiyeh was the president and controlling shareholder of Quality Realty Construction, Inc. ("QRCI"). In 1996, QRCI sold a building to Regional Realty Holding, Inc. ("RRHI"), subject to a purchase money mortgage. On February 7, 1997, QRCI filed for bankruptcy under Chapter 11.

The bankruptcy court entered an order that required the debtor to deposit all mortgage payments received from RRHI in a debtor-in-possession ("DIP") account. The bankruptcy court expressly prohibited the debtor from disbursing any of the funds received from RRHI unless the court authorized the disbursement. The debtor established four DIP accounts.

Between March 1997 and August 2000, the defendant, without authorization, wrote checks and made withdrawals from the DIP accounts totaling approximately $280,000. Compounding his wrongdoing, the defendant proceeded to submit false monthly operating reports to the bankruptcy court in an effort to conceal these transfers of estate assets. Additionally, the

defendant deposited checks, drawn on accounts with insufficient funds that he controlled, into the DIP account in order to create falsely inflated DIP account balances to further conceal his embezzlement. The defendant was indicted under Sections 152 and 153.

The *Atiyeh* defendant attempted to have the criminal indictment dismissed, arguing that the counts were multiplicative, charged the same offense in two or more counts, and violated the double jeopardy clause of the United States Constitution.[193]

The court noted that embezzlement under Section 153 requires that a person knowingly and fraudulently appropriate or embezzle property belonging to the debtor's estate.[194] In contrast, fraudulent concealment requires that a person knowingly and fraudulently conceal, in connection with a bankruptcy case, any property belonging to the debtor's estate. The latter does not require that the person be in a fiduciary relationship or that the property be misappropriated for the person's own use. The court noted that Section 153 requires proof of embezzlement, whereas Section 152 does not, and, similarly, Section 152 requires concealment, while Section 153 does not. Therefore, the *Atiyeh* court found that the two counts addressed two different and separate criminal offenses, and thus the defendant may be convicted of both crimes.[195]

Bankruptcy Fraud—18 U.S.C. § 157

Pursuant to Section 157 of title 18 of the United States Code,[196] it is a bankruptcy crime for a person to utilize a bankruptcy filing or related document for the purpose of carrying out or concealing a fraudulent scheme. While Sections 152 and 153 criminalize certain actions or inactions of a person involved in a bankruptcy proceeding, Section 157 aims to prevent a person from utilizing the Bankruptcy Code to commit fraud or conceal fraud.

Section 157 was passed as part of the Bankruptcy Reform Act of 1994[197] and represented the first bankruptcy crime statute passed since 1898.[198] At the time of its passage, there had been increased evidence of individuals using the Bankruptcy Code and, in particular, the protection provided for by the automatic stay of Section 362(a), in unanticipated ways. Congress enacted Section 157 in an attempt to prevent the use of the Bankruptcy Code to advance or conceal a fraudulent scheme.

To be in violation of Section 157(1), a bankruptcy petition in furtherance of a plan to defraud or conceal fraud is required to be filed.[199] Under Section 157(2), a violation occurs when one also files a pleading in a bankruptcy case in furtherance of a plan to defraud or in an effort to conceal such fraud.[200] The distinction between Sections 157(1) and 157(2) is that in the latter, a bankruptcy proceeding already exists, and the ongoing bankruptcy process is used to advance or conceal a fraudulent scheme. Finally, under Section 157(3), making a false or fraudulent representation related to a bankruptcy proceeding constitutes a violation under the statute.[201] A written pleading is not required; rather, any false representation, whether made in writing or filed in court is sufficient. This includes false testimony or a false declaration and commonly arises when a person fraudulently represents the existence of a bankruptcy case.[202]

Courts have recognized these elements for bankruptcy fraud under Section 157:

> 1) the existence of a scheme to defraud or intent to later formulate a scheme to defraud and 2) the filing of a bankruptcy petition 3) for the purpose of executing or attempting to execute the scheme.[203]

In *United States v. Brown,*[204] the court found that the defendant met all of these elements.[205] The defendant devised a scheme to defraud homeowners and lenders by working with debtors to file falsified real estate deeds in the bankruptcy petitions of the debtors in an effort to frustrate

foreclosure proceedings.[206] The defendant argued that debtors may legitimately file for bankruptcy in order to delay foreclosure proceedings, and thus her scheme was not an effort to defraud.[207] The court, however, pointed out that unlike legitimate bankruptcy petitions, the petitions here were based on fictitious deeds of trust that were created by the defendant. Based on this evidence, the court concluded that there was sufficient evidence to find that the defendant had a scheme to defraud, and the defendant assisted debtors in the filing of bankruptcy petitions in furtherance of a scheme to defraud the homeowners and lenders. The defendant's conviction was upheld.

Miscellaneous Bankruptcy Crimes—18 U.S.C. §§ 154, 155, and 156

Sections 152, 153, and 157 of Title 18 of the United States Code are the most relevant bankruptcy crime statutes for purposes of detecting and/or preventing fraud. There are, however, three other bankruptcy crime statutes, Sections 154, 155, and 156 of Title 18, that should also be of concern to professionals assisting individuals or corporations in bankruptcy. While these sections are more specific and, therefore, more limited in their application, they are equally important.

Section 154 provides that dishonest officers of the bankruptcy court (including trustees) can be criminally punished for (1) knowingly purchasing any property of the bankruptcy estate to which the person is an officer; (2) knowingly refusing to permit an interested party from having a reasonable opportunity to inspect the documents of the estate which are in the officer's possession when such interested party has court authority to inspect such documents; and (3) knowingly refusing to permit the United States Trustee from having a reasonable opportunity to inspect the estate documents within the officer's control.[208]

Section 155 makes it a criminal offense to knowingly and fraudulently enter into an arrangement to fix the fees or compensation to be paid from the estate.[209] Under Section 155, "attorneys may not knowingly and fraudulently enter into agreements, express or implied, for the purpose of fixing compensation to be paid in a bankruptcy case."[210] Compensation and reimbursement of professional persons is allowed after notice and a hearing and judicial review pursuant to Section 330 of the Bankruptcy Code. In *Lutheran Hospitals & Homes v. Duecy,*[211] the Ninth Circuit Court of Appeals held that the purpose of Section 155 "is to keep the fees under the control of the court to prevent trustees, creditors and others, and their counsel, from playing fast and loose with other people's money in courts of bankruptcy."[212]

Finally, Section 156 makes it a criminal offense to knowingly disregard a bankruptcy law or rule.[213] Unlike the other bankruptcy crimes, Section 156 applies only to a "bankruptcy petition preparer."[214] Essentially, Section 156 makes it unlawful in certain situations for a nonattorney bankruptcy preparer to intentionally disobey the Bankruptcy Rules or Bankruptcy Code.[215] The Bankruptcy Code defines a bankruptcy petition preparer as a person, other than an attorney, who prepares for compensation a document for filing.[216] The type of services, however, that a bankruptcy petition preparer can provide are limited. Some services a bankruptcy petitioner may provide include meeting with a prospective debtor and providing forms for the debtor to complete, without any assistance from the bankruptcy petition preparer. The bankruptcy petition preparer can also transcribe information provided by the debtor. The bankruptcy petition preparer cannot give legal advice or otherwise assist the debtor in completing the forms other than providing secretarial-type services. Also, pursuant to Section 110 of the Bankruptcy Code, the petition preparer is required to sign a debtor's petition or schedules and statement of financial affairs. If the bankruptcy petition preparer fails to comply with this

requirement, the bankruptcy petition preparer can face a fine, imprisonment, or both, pursuant to Section 156 of the United States Code.[217]

Punishment

Violations of Sections 152, 153, and 157 are subject to fines up to $250,000 and/or an imprisonment up to five years. Violations of Section 154 are subject to fines up to $250,000 and forfeiture of office. Violations of Sections 155 and 156 are subject to fines up to $250,000 and/or imprisonment of up to five years.

Obstruction of Justice—18 U.S.C. § 1519

Section 1519 of Title 18 of the United States Code was passed as part of the Sarbanes-Oxley Act of 2002 and provides enhanced punishments for alteration, falsification, or destruction of records designed to impede investigations of federal agencies or in connection with bankruptcy proceedings. There has not yet been any significant interpretation of this section by the courts;[218] therefore, the meaning of this broad statutory language is unclear.[219] The language of Section 1519 indicates that this section applies to Title 11 of the United States Code, which includes the Bankruptcy Code. Although this section is sometimes referred to as an anti-shredding provision (presumably it addresses the excesses alleged to have occurred within the Arthur Andersen accounting firm in connection with the Enron debacle), its language certainly goes beyond that characterization. Section 1519 also appears duplicative of the statutory language already found in Sections 152(8), 152(9), and 157 of title 18.

A violation of Section 1519 provides for punishment of up to 20 years imprisonment, while Section 157 provides for not more than 5 years imprisonment. Commentators have criticized the statutory language of Section 1519 for being undefined, unspecific, and vague.[220] Nonetheless, given its broad provisions and significant punishment, Section 1519 could act as a powerful tool to deter and punish fraud in a bankruptcy context.

FRAUDULENT TRANSFER STATUTES

While the Bankruptcy Code presents certain obstacles to all creditors, it can also enhance prospects for recovery, particularly concerning fraudulent transfers of property. Certain remedies are unique to the Bankruptcy Code, while others are creatures of state law that may also be enforced through a bankruptcy proceeding.

For centuries, debtors in financial distress have employed fraudulent devices in an effort to avoid having to pay or otherwise satisfy obligations owed to their creditors. At the same time, lawmakers have sought to enact legislation, and courts have endeavored to decide cases, so as to deter and/or set aside such fraudulent transactions. Both federal and state laws include provisions designed to remedy debtors' attempts to defraud creditors. Modern fraudulent conveyance law focuses on both traditional *actual fraud,* where the transferor acts with the intent to hinder, defraud, or delay creditors, and *constructive fraud,* where the financially distressed transferor engages in a transaction, or a series of transactions, resulting in a transfer of some or all of the transferor's assets (i) in exchange for something worth less than its reasonably equivalent value, or (ii) without receiving fair consideration.

All 50 states have adopted either the Uniform Fraudulent Conveyance Act ("UFCA") or the Uniform Fraudulent Transfer Act ("UFTA").[221] Under these state statutes, a creditor can attack

a transfer made fraudulently as to creditors based on the actual or constructive fraud of the transferor. If the transferor becomes a debtor under the Bankruptcy Code, the trustee or debtor-in-possession may institute a proceeding on behalf of creditors pursuant to similar provisions contained in Section 548 of the Bankruptcy Code. This section permits avoidance of fraudulent transfers that were made within two years[222] prior to the date that the bankruptcy petition was filed. Additionally, under the trustee's "strong-arm powers" of Section 544(b) of the Bankruptcy Code, the trustee or debtor-in-possession may also institute a proceeding to avoid any transfer that is voidable under applicable non-bankruptcy law (e.g., applicable state UFCA or UFTA laws). This ability to employ state law for the benefit of the bankruptcy estate may extend the so-called look-back period well beyond two years and enable the trustee or debtor in possession to avoid certain transactions that would otherwise be unassailable under Section 548.

State Law

Modern fraudulent conveyance law can be traced back to England's Statute of 13 Elizabeth, enacted in 1571. Many American jurisdictions either wholly adopted or relied on some form of the Statute of 13 Elizabeth.[223] Under Chapter 5 of the Statute of 13 Elizabeth, any conveyance of property made with the intent to "delay, hinder or defraud creditors" was deemed void.[224] The intent to delay, hinder, or defraud creditors is, however, rarely capable of direct proof.[225] Therefore, in an effort to achieve fair and just results, courts began to recognize certain "signs and marks of fraud" from which a court can infer the requisite intent.[226] These commonly referred to "badges of fraud" include transfers to friends or relatives, transfers for no consideration, secret transfers, transfers where the debtor remains in possession of and continues to use the property, and transfers made when creditors have already commenced collection activity.[227]

Twyne's Case, the seminal English case on fraudulent conveyance law that is still cited and relied on by modern courts, provides a typical fact pattern to which fraudulent conveyance laws would apply. In *Twyne's Case,* the debtor, Pierce, owed "C" £200 and owed Twyne £400. Pierce secretly transferred his property, including his sheep, to Twyne. Pierce, however, retained use and possession of the sheep, including selling certain sheep, shearing and marking others, and generally behaving as if the sheep were still Pierce's property. In an effort to collect his £200, C sent a sheriff to levy on the sheep that C thought were Pierce's property. Friends of Twyne prevented the sheriff from seizing the property, indicating that the sheep no longer belonged to Pierce, but were instead owned by Twyne. In reaching its conclusion that Pierce's transfer to Twyne was fraudulent as against Pierce's creditors, the court noted six "signs and marks of fraud" (now generally referred to as badges of fraud), namely:

1. The "gift" was a general transfer of all of Pierce's property, including necessities.
2. Pierce retained possession of the property and continued to use it as if it were his own.
3. The transaction was secret.
4. The transfer was made while C was pursuing collection activity against Pierce.
5. There was a friendship between Pierce and Twyne.
6. The transfer document explicitly recited the transfer was made "honestly, truly, and bona fide."[228]

Twyne's Case illustrates that courts first presented with fraudulent transfer cases were focused on debtors' bad conduct to protect their interest in their property at the expense of their creditors.

Uniform Fraudulent Conveyance Act.[229] In 1918, in an effort to modernize and make uniform fraudulent conveyance laws, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") promulgated the Uniform Fraudulent Conveyance Act.

The UFCA proved successful in reducing confusion, inconsistencies, and uncertainty in the law. The UFCA not only codified established common law principles, it also clarified substantive issues and simplified procedures. For example, in addition to continuing to invalidate transfers made with "actual fraudulent intent," the UFCA introduced the concept of "constructive fraud," by including provisions to invalidate conveyances without regard to the party's actual intent. In analyzing actual fraud cases under the UFCA, courts continued to rely on the traditional badges of fraud that had developed at common law to establish a party's subjective intent. In the case of *In re Reed's Estate,*[230] the court explained that:

> Since it is impractical to look into a person's mind to ascertain his intention, it is necessary to consider surrounding circumstances. Since it is most difficult to prove intent by direct evidence, circumstantial evidence is necessary. The issue of actual fraud is commonly determined by recognized indicia, demonstrated badges of fraud, which are circumstances so frequently attending fraud; a concurrence of several will make out a strong case and be the circumstantial evidence sufficient to sustain a court's finding.[231]

As explained in greater detail later, the badges of fraud commonly relied on by courts include: the relationship between the debtor and the transferee; the consideration for the conveyance; any insolvency or indebtedness of the debtor; how much of the debtor's estate was transferred; a reservation of benefits, control, or dominion by the debtor; and any secrecy or concealment of the transaction.[232]

The UFCA identifies several situations involving "constructive fraud" that may be attacked based on certain objective criteria. Specifically, a conveyance may be deemed "constructively fraudulent" as to creditors if it is not supported by "fair consideration" and one of these three conditions is met:

1. The transferor is insolvent or rendered insolvent by the transfer.[233]
2. The transferor is engaged or about to engage in a business or transaction for which the property remaining in his hands after the conveyance is unreasonably small.[234]
3. The transferor intends or believes that he will incur debts beyond his ability to pay as they mature.[235]

An essential element of a "constructive fraud" claim is lack of "fair consideration." Section 3 of the UFCA provides that:

> Fair consideration is given for property, or [an] obligation, (a) [w]hen in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or (b) [w]hen such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.[236]

What is fair consideration must be determined by the facts of each case.[237] Courts agree, however, that a promise of future support is not fair consideration.[238]

Uniform Fraudulent Transfer Act.[239] The Uniform Fraudulent Transfer Act was proposed by the NCCUSL in 1984 as a replacement for the UFCA and to update fraudulent conveyance law to reflect changes incorporated into the Bankruptcy Code in 1978 and certain provisions of the Uniform Commercial Code.

The UFTA continued the long-standing rule prohibiting transactions consummated with an actual, subjective intent to hinder, delay, or defraud creditors.[240] In contrast to the UFCA (which failed to provide courts with any guidelines for establishing actual intent), Section 4(b) of the UFTA acknowledges the usefulness of objective criteria by listing a number of factors that courts *may* consider in assessing the transferor's and transferee's subjective intent.[241] The factors listed in Section 4(b) of the UFTA correspond closely to the badges of fraud that had developed under the common law to create a presumption of fraudulent intent. Comment 5 to the UFTA makes clear that the factors listed in Section 4(b) should be considered as mere relevant evidence and do not constitute presumptions of fraud.[242] The comments to the UFTA also encourage courts to consider any circumstantial evidence that may negate a conclusion of fraudulent conduct.[243]

Similar to the UFCA, under the UFTA certain transactions may be challenged as fraudulent solely because objective factors indicate that the rights of unsecured creditors are affected by the transaction.[244] Both the UFCA and the UFTA consider these "constructively fraudulent" transfers sufficiently harmful to creditors to justify avoidance of the transfer, regardless of the actual intent of the parties.[245] Under the UFTA, a transaction may be set aside as "constructively fraudulent" if: (i) the transfer was made or the obligation incurred for less than "reasonably equivalent value,"[246] and (ii) one of these three situations exists:

1. The transferor is insolvent.[247]
2. The transferor's business is left with "unreasonably small capital" or "unreasonably small assets."[248]
3. The transferor intended to incur or believed, or reasonably should have believed, that it was incurring debts beyond its ability to pay them as they came due.[249]

In contrast to the UFCA's "fair consideration" definition that considers the value received by the transferor *and* the good faith of the transferee,[250] the UFTA removes the issue of the transferee's good faith from the constructive fraud analysis. Instead, the UFTA focuses on the transferor's receipt of "reasonably equivalent value" and ignores the good faith of the transferee.[252] Under the UFTA, however, a transferee may assert its good faith as a defense to the action.[252]

The UFTA fails to define "reasonably equivalent value," instead adopting the Bankruptcy Code's general approach to the concept.[253] The determination of "reasonably equivalent value" generally involves simply comparing the value of what was transferred with what was received.[254] For example, the court for *In re Shape* explained that a payment of $70,000 for stock worth more than $1.5 million lacks reasonably equivalent value.[255] Similarly, the court in *BFP v. Resolution Trust Corporation* explained that, in most cases, the traditional common law notion of fair market value is the benchmark for determining reasonably equivalent value.[256] Decisions interpreting the bankruptcy definition of value do not, however, offer certainty or predictability because courts have concluded that the fact finder must have considerable discretion in determining whether reasonably equivalent value was exchanged.[257] Moreover, the case law does not establish a fixed percentage or safe harbor, but it does indicate that courts will consider all the facts and circumstances surrounding the particular transaction, including the type of value exchanged.[258]

Who May Commence an Action. Under the UFCA and the UFTA, creditors whose claims have matured at the time a suspect transaction occurs (i.e., present creditors), *and* creditors

whose claims arise after the transaction but before the action to avoid the transfer is commenced (i.e., future creditors) may challenge transfers constituting actual fraud.[259] Only *present* creditors may challenge constructively fraudulent transfers made for inadequate consideration when the transferor is insolvent.[260] Both present *and* future creditors, however, may challenge constructively fraudulent transfers made for less than adequate consideration where the debtor (i) is left with unreasonably small assets and (ii) intends to incur debts beyond its ability to pay.[261]

Federal Law

Bankruptcy Code Section 548.[262] Section 548 of the Bankruptcy Code provides a vehicle to attack fraudulent transfers made by a person or entity that subsequently becomes a debtor under the Bankruptcy Code. Section 548 is based, in large part, on the UFCA. Similar to the UFCA and the UFTA, Section 548 provides that a trustee or debtor-in-possession can avoid certain transfers made by the debtor within two years[263] of the filing of a bankruptcy petition (i) if certain financial tests are met (i.e., constructive fraud)[264] or (ii) if actual intent to hinder, delay, or defraud creditors is established (i.e., actual fraud).[265]

Application of UFCA and UFTA under the Bankruptcy Code. Notwithstanding the existence of the fraudulent transfer provisions of Section 548 of the Bankruptcy Code, the UFCA and the UFTA continue to play an integral role in fraudulent transfer avoidance under the Bankruptcy Code. Given the similarities in the statutes, cases decided under the UFCA and UFTA are considered persuasive authority for similar issues arising under Section 548 of the Bankruptcy Code.[266] Additionally, under Section 544 of the Bankruptcy Code, trustees and debtors-in-possession are given the status of a hypothetical lien creditor, thereby allowing trustees (or debtors-in-possession) to step into the shoes of a creditor of the debtor and utilize applicable state law (i.e., UFCA or UFTA) to seek to avoid a transaction that a creditor would have been able to attack but for the debtor's bankruptcy filing.[267]

Section 544's "strong arm" power provides the trustee (or debtor-in-possession) with, minimally, two advantages over using Section 548 of the Bankruptcy Code or the UFCA or UFTA outside of bankruptcy. First, utilizing the UFCA or the UFTA significantly expands the trustee's (or debtor-in-possession's) avoiding powers by allowing the trustee to utilize the significantly longer statutory "reachback" periods of the UFTA and the UFCA (which typically provide for a four- to six-year reachback period depending on the state), rather than the two-year time frame permitted under Section 548 of the Bankruptcy Code. Second, by utilizing the UFCA and the UFTA pursuant to Section 544(b) of the Bankruptcy Code, the trustee is able to pursue a claim on behalf of all creditors. As long as there is one creditor in existence at the commencement of the case who can challenge the transfer under applicable state law, the trustee can bring the action on behalf of all creditors of the debtor. By contrast, absent the benefit of Section 544, an individual creditor might not be economically motivated to bring an action to avoid a transfer under the UFCA or UFTA because the legal expense involved with the action might be cost prohibitive. Additionally, it would be left to each creditor to bring an action against the transferee for each such creditor's own individual benefit.

Recent Amendments to the Bankruptcy Code. The Bankruptcy Abuse Act, which went into effect on October 17, 2005, substantially amended the Bankruptcy Code, specifically as it relates to fraudulent activity. A driving force behind the Bankruptcy Abuse Act was the belief that the bankruptcy laws were being abused by undeserving debtors.[268] The recent amendments

to the Bankruptcy Code were designed to prevent this perceived abuse. Several of the amendments to the Bankruptcy Code, promulgated by the Bankruptcy Abuse Act, address issues of fraud and fraud avoidance.

- *Fraudulent transfer "look-back" period.* Prior to enactment of the Bankruptcy Abuse Act, Bankruptcy Code Section 548 provided that a trustee (or debtor-in-possession) may avoid any transfers of an interest of the debtor in property that were made or which occurred within *one year* before the date of the filing of the bankruptcy petition. The Bankruptcy Abuse Act amended this Section to increase the "look-back" period from one year to two years.

  This amendment applies only to cases that are commenced one year after the effective date of the Bankruptcy Abuse Act (October 17, 2005). Thus, for any bankruptcy case commenced prior to October 17, 2005, the debtor will only have the ability to avoid fraudulent transfers made within one year of the bankruptcy filing.

  The expansion of the "look-back" period from one year to two years represents a significant change and brings the Bankruptcy Code current and consistent with the provisions of state law regarding fraudulent transfers as articulated in the UFTA and the UFCA. The delayed enactment feature is also significant as it gives debtors fair warning that the fraudulent transfer period has been expanded. Professionals advising debtors should be aware of the revised Section 548 and its ramifications.

- *Avoidance of insider compensation.* In addition to extending the "look-back" period for the avoidance of fraudulent transfers from one year to two years, the Bankruptcy Abuse Act also amended Section 548 to expand the types of transfers that can be avoided. Under amended Section 548, there is now an express provision for a debtor to avoid a transfer, or the incurrence of an obligation, to or for the benefit of an "insider" under an employment contract which is not made in the ordinary course of business.[269]

  Moreover, a review of illustrative cases decided under Section 101(31) provides some further insight as to the meaning of the term "person in control" for purposes of determining who might be an insider. An attorney can be an insider if he or she exercises such control or influence over the debtor as to render their transactions not at arm's length.[270] A voting arrangement between all stockholders of the debtor and individual members of a limited partnership, effectively giving the members control over the corporation, resulted in all parties being considered "persons in control" for purposes of Section 101(31).[271]

  This revision to the Bankruptcy Code means that debtors will not be allowed to fraudulently transfer assets to or for the benefit of "insiders" by creatively structuring the transfers as part of an employment compensation package. Unless the employment contract was made in the ordinary course of the debtor's business, any transfer, or incurrence of an obligation, to or for the benefit of an insider will be subject to avoidance and recovery for the benefit of the debtor's creditors.

- *Ten-year bankruptcy planning reachback.* The Bankruptcy Abuse Act also amends Section 548(e)(1) of the Bankruptcy Code to provide that a transfer can be avoided if:

  (a) A debtor transfers property to a trust

  (b) Of which the debtor is a beneficiary

  (c) Within 10 years of the bankruptcy filing

  (d) With the intent to hinder, delay or defraud creditors.

  This change is significant in that the prior reachback provision under Section 548 was limited to one year.

INTENTIONALLY FRAUDULENT TRANSFERS

As discussed earlier, modern fraudulent transfer statutes are designed to address both actual (i.e., intentional) fraud and constructive fraud. To prove that a transfer was intentionally fraudulent under the UFCA, UFTA, or Section 548 of the Bankruptcy Code, a plaintiff must demonstrate that the transfer was perpetrated "with actual intent to hinder, delay, or defraud" creditors.[272] As noted, however, direct evidence of a fraudulent intent is often unavailable. Therefore, under the UFCA and the Bankruptcy Code, courts generally rely on circumstantial evidence to infer fraudulent intent.[273] When evaluating the circumstances of a transaction, courts have often relied on badges of fraud that include:

- The relationship between the debtor and the transferee
- The consideration for the conveyance
- Any insolvency or indebtedness of the debtors
- How much of the debtor's estate was transferred
- A reservation of benefits, control, or dominion by the debtor
- Any secrecy or concealment of the transaction[274]

Rather than relying exclusively on the courts to develop this evidence of fraud, the drafters of the UFTA provided a nonexclusive list of the indicia of actual fraudulent intent. This list includes, among other things, the debtor (i) transferring property or incurring an obligation to an insider; (ii) not disclosing, or concealing, a transfer or obligation; or (iii) retaining possession or control of property after its transfer by the debtor.[275] The factors listed in the UFTA are those that courts have historically relied on when determining the existence of actual fraud.

The court in *Huennekens v. Gilcom Corp. of Va. (In re Sunsport, Inc.)*[276] explained that a prima facie intentional fraud case may be established under Section 548 of the Bankruptcy Code and the UFTA by showing the presence of indicators of fraud.[277] In reaching its conclusion that an alleged prepetition "sale transaction" involving all of the debtor's assets constituted an intentional fraudulent transfer, the *Sunsport* court relied on these facts as evidence that several of the badges of fraud were present:

- The sale "transaction was obviously constructed very hastily and with hardly any regard for formalities" and with only minimal involvement of accountants and lawyers even though the principal of the "buyer" was found to be a "shrewd businessman."[278]
- Two officers and directors of the selling debtors stayed on as officers and directors of the "buyer."[279]
- The consideration paid was grossly inadequate.[280]
- The creditors of the selling debtors were "pressing very hard against the company at the time it transferred its assets to" the defendant.[281]
- The debtor's "principals were evasive, uncooperative, and actually concealed the asset transfer on [debtor's] bankruptcy schedules."[282]

As noted by the Fourth Circuit in *Tavenner v. Smoot,*[283] any transfer between related parties will be closely scrutinized by courts and, if made without adequate consideration, will create a presumption of actual fraudulent intent.[284] In *Smoot,* the defendant, Ken Smoot, received $217,059.25 in settlement of a personal injury action. Smoot promptly (the same day) transferred the settlement proceeds to Glass Apple Corporation, a family corporation of which he

was the president, his wife was the vice president, and his son was the secretary and treasurer. Smoot's wife held 50 percent of Glass Apple's stock, and his children held the rest. Glass Apple then distributed such proceeds out to Smoot and his family in the form of loans, "wages," a car for his wife, and a motorcycle for his son.

Two months after receipt of the settlement proceeds, and at a time when Smoot was otherwise experiencing personal financial problems, Smoot was ordered to pay approximately $350,000 in connection with a federal wiretapping action that had been commenced against him by his former employer and a union. After filing a personal Chapter 7 bankruptcy proceeding, wherein Smoot claimed an exemption for the settlement funds pursuant to a Virginia law creating an exemption for money recovered in personal injury actions, Smoot's Chapter 7 Trustee sued Smoot and his family members that had received the benefit of the transfers made by Glass Apple.[285] The court of appeals noted that because the transfers were made between related parties, there was a presumption of actual fraudulent intent on the part of Smoot to hinder, delay, or defraud his creditors.[286] The court explained that this presumption established the trustee's prima facie case and shifted the burden of proof to the debtor to establish the absence of fraudulent intent.[287] Since Smoot had not rebutted the presumption of actual fraud raised after he transferred the proceeds to a corporation owned entirely by members of his immediate family without consideration, the trustee was entitled to avoid the transfer.[288]

CONSTRUCTIVELY FRAUDULENT TRANSFERS

Even absent evidence of actual intent on the part of the transferor to hinder, delay, or defraud creditors, a transfer can still be challenged as fraudulent by establishing "constructive fraud." A constructively fraudulent transfer is one in which: (1) a transferor does not receive "fair consideration" or "reasonably equivalent value" in exchange for the transfer, *and* (2) in which the transferor: (a) is insolvent at the time of the transfer or is rendered insolvent because of the transfer; (b) retains unreasonably small capital with which to operate its business; *or* (c) intends to incur debts beyond its ability to pay as those debts mature.[289] There is no requirement to show ill intent on the part of the transferor; the focus is on the net effect of the transfer on the debtor's estate rather than on the intent of the transferor.[290]

"Fair Consideration" or "Reasonably Equivalent Value"

The outcome in many constructive fraud cases under the UFCA turns on the question of "fair consideration," which is defined as a fair equivalent given in good faith.[291] By including a good faith requirement under the UFCA, the drafters directed the inquiry into the nature of the exchange attacked. Therefore, even when a conveyance is challenged without regard to actual intent to defraud, a court must consider the good faith of the transferee. [292]

In determining whether the value received by the transferor was reasonably equivalent (the standard utilized under the UFTA and Section 548 of the Bankruptcy Code), the focus is on the quantifiable economic consideration received by the transferor in exchange for the transfer, rather than on the value given up by the transferee.[293]

Neither the Bankruptcy Code nor the UFTA provides a definition of "reasonably equivalent value." As noted by the Supreme Court in *BFP v. Resolution Trust Corp.*,[294] "of the three critical terms 'reasonably equivalent value,' only the last is defined: 'value' means, for purposes of [Section] 548, 'property, or satisfaction or securing of a . . . debt of the debtor.'"[295] Accordingly,

"Congress left to the courts the obligation of marking the scope and meaning of [reasonably equivalent value]."[296] The lack of a precise definition presents an especially difficult task for courts in cases where a debtor exchanges cash for intangibles, the values of which are difficult, if not impossible, to ascertain.[297]

The court in *Mellon Bank, N.A. v. The Official Committee of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*[298] was presented with the task of valuing an intangible asset.[299] In *Mellon*, the debtor paid Mellon Bank $515,000 in loan commitment fees in connection with a formal loan commitment letter (that was subject to numerous closing conditions) issued by it.[300] After the loan failed to close, the debtor filed a Chapter 11 bankruptcy proceeding, and the Committee sued the bank to recover the $515,000 as a fraudulent transfer under the Bankruptcy Code. In defense of the action, Mellon argued, among other things, that the commitment letter conferred "reasonably equivalent value" on the debtor (i) measured by the fair market value of the services it provided and (ii) because the letter provided a financially troubled company with the "chance" of obtaining financing that could save it from bankruptcy.[301] The court agreed with Mellon that the mere opportunity to receive an economic benefit in the future may constitute "value" under the Bankruptcy Code.[302] The court, however, ultimately concluded that, based on the numerous conditions in the loan, it was unlikely that the debtor could have ever closed the loan and, therefore, the debtor had exchanged "substantial fees for an extremely remote opportunity to receive value in the future."[303] The court concluded that this minimal "value" was not reasonably equivalent to the fees the debtor had remitted to Mellon and ordered Mellon to return the portion of the fees not related to true out of pocket expenses incurred by Mellon.[304]

Transfers Made When the Transferor Was Insolvent, and Transfers that Made the Transferor Insolvent

UFCA. The UFCA uses a "balance sheet test" for determining insolvency.[305] Under Section 2(1) of the UFCA, "[a] person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."[306] Courts have made clear that insolvency is determined "as of the time of the conveyance."[307] "Present fair salable value" means the value that can be obtained if the assets are sold with reasonable promptness in an existing (not theoretical) market.[308]

When a bankruptcy filing is not "clearly imminent" on the date of the challenged conveyance, the weight of authority holds that assets should be valued on a going concern basis.[309] When an entity is determined to be on its "deathbed" at the time of the conveyance, a liquidation value should be used.[310] Under this complicated calculation, debtors may be insolvent (for UFCA purposes) even when the value of their assets exceeds the amount of their debts, if the assets are illiquid and the debts are short term.[311]

UFTA and 11 U.S.C. § 548. Both the UFTA and Section 548 of the Bankruptcy Code use a simplified version of the UFCA "balance sheet" test for insolvency. Under the UFTA and Section 548, debtors are insolvent if the sum of their debts is greater than that of their assets "at a fair valuation."[312] The definition of assets is expansive and includes unliquidated and contingent claims.[313] Contingent assets and liabilities should not be considered at face value but rather must be discounted by the probability that the contingency will materialize.[314] Both

the UFTA and Section 548 exclude any property that was transferred, concealed, or removed with the intent to hinder, delay, or defraud creditors when valuing the debtor's assets.[315] Additionally, under the UFTA, the debtor is presumed to be insolvent if the debtor is not paying debts as they come due.[316]

In attempting to value a debtor's guarantee of its parent corporation's debt (i.e., a contingent liability), the court in *Covey v. Commercial National Bank*[317] concluded that the liability must be discounted by the probability that the contingency will materialize.[318] The court determined that the proper method of valuing the guarantee was to multiply the total guaranteed debt by the probability that the guarantor would be called upon to satisfy the obligation.[319]

In *Official Committee of Former Partners v. Michael G. Brennan (In re Labram & Kuak, LLP)*,[320] the court was faced with the issue of the proper valuation of a stream of future liabilities in determining the solvency of the debtor law firm.[321] In *Labram*, the official committee of former partners[322] of the dissolved debtor law firm and the official committee of unsecured creditors brought a fraudulent transfer action against a former partner of the debtor law firm to recover distributions made by the debtor prior to the bankruptcy case. In attempting to demonstrate that the debtor was insolvent at the time of the distributions, the plaintiffs' expert designated the entire amount of the debtor's "contingent lease payables" (i.e., its future monthly rent obligations under leases extending for several years) as liabilities. In reaching its decision not to include the entire amount of the "contingent lease payables" as a liability in the insolvency analysis, the court explained that "it is logical not to include all of the future rent as liabilities because this calculation miscategorizes the future rent liabilities as an obligation presently due in full, while, if the debtor remained a going concern, would have consisted of making installment payments in the future during the tenancy."[323] The court went on to explain that "if accounting to render all future rents immediately payable could be done as to rent, it could be so done with respect to any projectable future expense. Again, this would render any business with substantial projectable future expenses artificially deemed insolvent."[324]

Unreasonably Small Capital or Inability to Pay Debts

With a debtor-transferor situation, the fraudulent transfer acts allow a creditor, the trustee, or the debtor-in-possession to attack a constructively fraudulent transfer by establishing that the transfer left the debtor with (i) unreasonably small capital or (ii) an inability to pay its debts, rather than proving that the debtor was insolvent at the time of the transfer.[325]

Unreasonably Small Capital. Section 548(a)(1)(B)(i) to (ii)(II), UFCA Section 5, and UFTA Section 4 apply to transfers and obligations for less than a reasonably equivalent value that leave the debtor with unreasonably small capital for the continuance of a business or transaction. The debtor does not need to be insolvent at the time of the transfer or rendered insolvent as a consequence of the transfer.[326] The critical inquiry in determining whether a transfer or conveyance has left a company with unreasonably small capital involves weighing the raw financial data against both the nature of the enterprise itself and the extent of the enterprise's need for capital during the period in question.[327]

In the context of a UFCA Section 5 challenge, the court in *Barrett v. Continental Ill. Bank and Trust Co.*[328] explained the importance of considering the nature and extent of the transferor's business subsequent to the transfers.[329] In *Barrett,* the record demonstrated that the transferor, Eastern Capital Corporation ("Eastern"), was "perennially short of cash."[330] Two former owners and creditors of Eastern commenced an action against the defendant Continental to

recover a $2 million transfer from Eastern to Continental, claiming that subsequent to the transfer, Eastern was left with unreasonably small capital. The $2 million transfer to Continental at issue in the case existed initially in the form of certificates of deposit issued by Continental.[331] The owner of Eastern transferred these certificates to Eastern to cover its capital requirements when he purchased the commodities brokerage.[332] When the certificates matured, the sole shareholder of Eastern caused Eastern to transfer the $2 million back to Continental.[333] The court initially noted the "somewhat unusual" situation, "for the challenged transfer was made by a company that was indisputably going out of business at the time the transfer was made."[334] The court explained that other courts have observed "that the basic purpose of [Section] 5 [of the UFCA] is to 'prevent an undercapitalized company from being thrust into the market place to attract unwary creditors to inevitable loss.'"[335] In reaching its conclusion that the debtor was not left with unreasonably small capital, the court acknowledged that, viewed in isolation, the $2 million transfer clearly left Eastern insolvent or nearly insolvent. The court held that "when the transfer is placed in the broader context of the operations Eastern contemplated during the spring of 1984 [when Eastern was essentially winding down its operation], the $2 million payment to Continental does not appear to us to have left the company with an 'unreasonably small capital.'"[336]

Inability to Pay Debts. Bankruptcy Code Section 548(a)(1)(B)(i) to (ii)(III), UFCA Section 6, and UFTA Section 4 apply to transfers and obligations for less than a *reasonably equivalent value* at a time when the debtor intended to incur or believed that the debtor would incur debts beyond the debtor's ability to pay as they came due. Solvency at or around the time of the transfer is not a defense to an attack under these provisions. It is unnecessary to prove particular debts have been contemplated; a general intention is enough.[337] Existence of an intent or belief concerning a debtor's ability to pay debts is a question of fact to be decided by the court.[338]

While there has not been a significant amount of case discussion on this subject, the court for *In the Matter of Farmers Federal Cooperative, Inc.*[339] was asked to decide whether the debtor intended to incur debts beyond its ability to pay when it issued chattel mortgages to its lender, McMillen Federal Finance ("McMillen").[340] The debtor issued three chattel mortgages to McMillen in exchange for three separate loans that the debtor used to purchase livestock. Based on testimony of an employee of the debtor that, prior to the granting of the first mortgage, McMillen was "experiencing difficulties in meeting its debts as they matured" and that he believed that the debts existing as of the date of the granting of the first mortgage, as well as subsequently incurred debts, "were beyond the Company's ability to pay as they matured," the court concluded that the debtor intended to incur debts beyond its ability to pay.[341] Accordingly, the court voided the mortgages granted to McMillen as fraudulent conveyances.[342]

APPLICATION OF FRAUDULENT TRANSFER LAWS

As debtors began to engage in more sophisticated commercial transactions, fraudulent transfer law and, specifically, the constructive fraud aspect of it evolved to address modern realities.

Leveraged Buyouts

One type of transaction that has engendered a significant amount of fraudulent transfer litigation is the leveraged buyout ("LBO"). In general terms, an LBO is a method of purchasing

a company whereby the acquirer leverages (i.e., borrows against) the assets of the target company to finance the purchase of the target company's shares or assets.[343] An LBO can be thought of as three separate transactions:

1. The buyer's lender advances funds to the buyer, usually through an entity formed solely for the purpose of making the acquisition.
2. The acquirer uses the funds to purchase the target's assets or stock.
3. The acquirer causes the target to collateralize the original loan by granting liens on its assets and/or payment guaranties to the lender.

Given their structure, LBOs can be detrimental to creditors of the target company. The proceeds of the loans obtained by the acquiring company from the lender (which are now collateralized by the assets of the new company) pass through to the target's shareholders. Therefore, unsecured creditors of the target, who normally would have been repaid ahead of equity holders in the event of a bankruptcy, typically find themselves subordinated to a significant amount of LBO secured debt.

Initially, courts struggled with the application of fraudulent transfer law to LBOs.[344] For example, the court in *Kupetz v. Wolf*[345] explained that fraudulent conveyance laws were designed to prevent collusive transfers between debtors and their families and should not be applied to LBO transactions because the "debtor-creditor relationship is essentially contractual."[346] Commentators also initially questioned the applicability of fraudulent transfer law to LBOs.[347] In their article entitled "Fraudulent Conveyance Law and Its Proper Domain," Douglas G. Baird and Thomas H. Jackson explained that "a firm that incurs obligations in the course of a buyout does not seem at all like the Elizabethan deadbeat who sells his sheep to his brother for a pittance."[348] Notwithstanding the initial struggle to apply fraudulent conveyance law to LBOs, the vulnerability of the typical LBO to fraudulent transfer attack has now been confirmed nearly unanimously by the courts.[349]

The District Court for the Middle District of Pennsylvania in *United States v. Gleneagles Investment Co.*[350] was the first court to recognize the applicability of fraudulent conveyance law to LBOs.[351] The district court's opinion was affirmed by the Third Circuit and has become the seminal case in this area. In *Gleneagles,* the LBO was structured such that the target company and its affiliates received loan proceeds from a lender in exchange for a mortgage on their assets. The target companies then loaned the loan proceeds to the acquirer, which paid the money to the target's shareholders in exchange for the stock of the target. The Third Circuit expressly held that fraudulent conveyance laws are applicable to LBOs.[352] In reliance on the broad language of Pennsylvania's fraudulent conveyance statute, the Third Circuit explained that "this broad sweep does not justify exclusion of a particular transaction such as a leveraged buyout simply because it is innovative or complicated."[353]

The cornerstone of challenging an LBO transaction as a fraudulent conveyance is the idea that, as first recognized by the *Gleneagles* court, the series of transactions involved in an LBO should be "collapsed" and viewed as a single transaction to determine whether sufficient consideration has been given. rather than reviewing the effect of each discrete transaction.[354] Once the series of transactions has been collapsed, it is nearly impossible for a lender to show that the target company received fair consideration when it collateralized the LBO loans because, in the end, substantially all of the cash has been distributed out to the shareholders of the target rather than remaining in the company.

The bankruptcy case of *In re Hechinger Investment Company of Delaware*[355] provides a more recent example of a relatively large LBO that survived a challenge as to certain of the

involved parties after the target company commenced a bankruptcy proceeding.[356] Prior to September 1997, Hechinger owned and operated stores under the Hechinger's and Home Quarters' trademarks. Until the Hechinger LBO, Hechinger and the England Family defendants retained control over the company with 70 percent of the voting power. From 1983 to 1996, Hechinger added 84 stores to the 34 stores that already existed. Due to intense competition in the industry, many of the stores were forced to close, and the corporation was left with a loss of $206 million for the seven-month period immediately preceding the LBO. Simultaneously, Builder's Square ("BSQ") was suffering from similar losses. Defendant Leonard Green & Partners ("Green") decided to acquire BSQ and merge it with Hechinger through an LBO.

After acquiring BSQ, the defendant acquired Hechinger through a triangular merger.[357] The Chase Bank Group financed both the BSQ acquisition and the Hechinger LBO with a loan amounting to $160.8 million in capital, after deducting fees and expenses. The loan was secured by all of BSQ's inventory, accounts receivable, and equipment. At this time, Chase Bank Group also loaned Hechinger $112 million, which, in relatively small part, paid off Hechinger's former capital lenders. The remaining $100 million was paid out to the shareholders, including Hechinger and the England Family. The inventory owned by Hechinger and BSQ was transferred in a series of steps to Hechinger Investment Company of Delaware ("HICD"), which became the permanent borrower under a $600 million secured loan made by the Chase Bank Group. A $243 million portion of the loan was used to pay off the BSQ loan, and $127 million of the loan was used to pay fees and to cash out the Hechinger shareholders. Hechinger emerged from the transaction with a 71.9 percent debt to capital ratio.

Shortly after the LBO, the ratings on Hechinger's senior notes and debentures dropped to poor standing. In the next 18 months, BSQ and Hechinger continued to lose money. By December 1998 Hechinger was in a severe liquidity crisis. Finally, after closing 34 BSQ stores, Hechinger and its affiliates voluntarily filed for Chapter 11 protection. Shortly after the filing and the closing of 89 additional stores, liquidation became inevitable.

The Official Committee of Unsecured Creditors of Hechinger Investment Company of Delaware (the "Hechinger Committee") and its affiliate debtors filed suit against various former directors and officers, as well as the controlling shareholders of Hechinger and certain lenders and investors who financed the Hechinger LBO. The plaintiff contended that Hechinger received less than reasonably equivalent value in exchange for the BSQ acquisition, including the payments to Hechinger's stockholders and the payment of transaction fees to Green and the Bank.

The court initially noted that the Third Circuit recognizes that multistep transactions can be collapsed when the steps of the transaction are part of one integrated transaction.[358] The court concluded that the steps of the transaction should be collapsed and considered as a single transaction because the directors, Green, and the bank all knew about the multiple steps of the transaction, and each step would not have occurred on its own.[359]

After rejecting the Hechinger Committee's intentional fraud claim as to the bank and Green, the court concluded that there was sufficient evidence in the record to imply fraudulent intent with respect to the directors:[360]

- The transaction may not have been completely disclosed to all of the directors.[361]
- The majority of the directors may have been "interested" directors, as the transaction was approved without a formal, uninterested director committee.[362]
- The directors that were also officers of Hechinger benefited substantially from the transaction, since prior to the transaction the board of directors increased their severance packages.[363]

Therefore, the court denied the directors' motion for summary judgment with respect to the plaintiff's intentional fraudulent conveyance claims.[364]

As to the Hechinger Committee's constructive fraud claims against the shareholders, the court concluded that the plaintiff did not satisfy its burden of proving that Hechinger had not received equivalent value through the transaction.[365] When determining the value of the transaction, the court here considered the fact that the merger of BSQ and Hechinger created a larger company which was more capable of competing in the current market.[366] Further, once the two companies were combined, the overhead costs of running both businesses were reduced.[367] The court also factored in the line of credit Hechinger produced as a result of the transaction and the newly combined accumulated assets from both companies that were valued at $260 million.[368] The fact that neither company was performing particularly well before or after the transaction had no bearing on the court's determination of value.[369] Furthermore, the $127 million paid out to the shareholders was far less than the value of assets acquired in the merger.[370] According to the court, this expressly defeated the plaintiff's argument that the money paid out to the shareholders in exchange for their shares was lost and never compensated.[371]

Similarly, the court concluded that the plaintiff failed to prove that Hechinger did not receive equivalent value for the fees paid out to Green.[372] An expert provided by Green testified that based on Green's work performance and industry standards, Hechinger received reasonably equivalent value for the payment of the management fees.[373] The court concluded that it was clear from the record that Green expended a significant amount of effort throughout the course of the transaction.[374] Obviously, this conclusion was tied to the court's determination that no actual or constructive fraud existed. Accordingly, the court granted defendant Green's motion for summary judgment with respect to the alleged constructively fraudulent transfers.[375]

Intercompany Guaranties

Lenders to one member of a corporate group will often require a guaranty of the debt from other members of the corporate group. Accordingly, creditors of a "stronger" member may be adversely affected if such member guarantees the bank debt of another "weaker" member of the corporate group.

A subsidiary's guaranty of a parent's obligation (an "upstream guaranty") frequently creates fraudulent transfer risk, as the court analyzes whether the subsidiary received "fair consideration" for its guaranty.[376] By contrast, when a parent company issues a guaranty for a subsidiary's obligations (a "downstream guaranty"), the fraudulent transfer risk is significantly lower since the parent (as the owner of the subsidiary) likely receives value from the additional credit obtained by the subsidiary.[377] A sister affiliate's guaranty of another affiliate's obligations (a "cross-stream guaranty") is likely to create the same fraudulent transfer risk associated with an upstream guaranty and will be subjected to the same scrutiny by the courts in determining whether an affiliate received "fair consideration" in guaranteeing the obligations of a sister company.[378]

Equivalent value will almost always be raised as a defense to a fraudulent transfer attack on a corporate guaranty. Equivalent value has been found to exist when a parent and subsidiary are part of an enterprise where each of their businesses benefits from the operations of the other and, therefore, access to additional credit can be said to benefit both group members.[379]

In *Tryit Enterprises v. General Electric Capital Corp. (In re Tryit Enterprises)*,[380] the plaintiffs were four related companies in the business of owning and operating rent-to-own franchises that leased home furnishings, electronics, and appliances. Prior to filing their Chapter 11 cases, the plaintiffs and another non-debtor affiliate entered into a loan agreement with General Electric

Capital Corporation ("GECC") pursuant to which GECC made approximately $7 million in financing available to the related entities to consolidate all of the outstanding obligations of the plaintiff and their nondebtor affiliates into one credit facility and provide funding to finance their daily operations. While each entity had guaranteed the entire obligation and each provided GECC with a security interest in their respective assets, each entity only received a portion of the loan proceeds.

In the ensuing bankruptcy case, the debtors-in-possession commenced an action against GECC to set aside the cross-collateralization and cross-guaranty provisions of the lending facility with GECC as fraudulent transfers under Texas law, contending that there was no fair consideration for the joint liability incurred by each plaintiff for the amount of the loan. The court ruled that the loan transactions were *not* voidable because they were made for fair consideration under the "single business enterprise" theory. As mentioned by the court, factors relevant to the "single business enterprise" analysis include a "single corporate" office that pays the bills for its affiliates, and each affiliate is charged with its proportional share of the main office expense, overlapping ownership among the business entities, centralized accounts, and where all entities are referred to by a single name.[381] In reaching its decision that the plaintiffs operated as a "single business enterprise," the court relied on, among other factors, the fact that the plaintiffs, as a group, were able to enter into the GECC facility, thereby providing them funding to continue to acquire inventory, finance their daily operations, pay off their existing obligations, and work with only one major secured creditor.[382] Separately, the plaintiffs would not have qualified for such financing.[383] Under these circumstances, the court found that the consideration given for the loans (i.e., the cross-guaranties of the plaintiffs) was "fair," and therefore the guaranties were not avoidable.[384]

Ponzi or Pyramid Schemes

Another transaction that has resulted in a significant amount of fraudulent transfer litigation is that of the pyramid or "Ponzi" scheme. As explained by one court:

> A "Ponzi" scheme is a term generally used to describe an investment scheme which is not really supported by any underlying business venture. The investors are paid profits from the principal sums paid in by newly attracted investors. Usually those who invest in the scheme are promised large returns on their principal investments. The initial investors are indeed paid the sizable promised returns. This attracts additional investors. More and more investors need to be attracted into the scheme so that the growing number of investors on top can get paid. The person who runs this scheme typically uses some of the money invested for personal use. Usually, this pyramid collapses and most investors not only do not get paid their profits, but also lose their principal investments.[385]

When a Ponzi enterprise fails and enters bankruptcy, the trustee is generally left with very few physical assets from which to pay creditors or investors that lost money. Often the only assets of the failed Ponzi enterprise are fraudulent transfer claims against those investors who received "returns" on their "investments." For example, in the Bennett Funding Group bankruptcy case,[386] the trustee filed over 10,000 fraudulent transfer lawsuits against former investors seeking recovery of over $100 million in transfers to investors.

The case of Bennett Funding Group, one of the largest bankruptcies involving a pyramid or Ponzi scheme, provides a typical example of the workings of this scheme. For years, Bennett Funding (and a number of related companies) leased office equipment and sold various

interests in those leases to third-party investors. By early 1996, Bennett Funding had sold approximately 7,400 different investment products with a stated value of over $2 billion to over 220 banks and other financial institutions and to thousands of individual investors. In March 1996, as a result of a lawsuit filed by the Securities and Exchange Commission alleging investor fraud, certain of the Bennett Funding companies filed for bankruptcy protection. As revealed by the schedules of assets and liabilities filed by the trustee in the bankruptcy case, Bennett Funding owed, on a consolidated basis, approximately 11,500 individual investors in excess of $674 million and owed banks and other financial institutions another $215 million. The structure of the scheme was best described by the bankruptcy trustee:

> Using the proceeds of sales to new investors and bank borrowing to make payments on earlier investments, more and more cash was consumed in maintaining a massive pyramid scheme.
>
> Cash from banks and investors alike in all of the Bennett entities was commingled in a "honey pot" account. Cash was moved from the honey pot through a maze of transactions, often with affiliates or an inner ring of business associates. Cash transfers resembled a pinball machine, bouncing from company to company and creating the appearance of economic activity. When the music stopped, the collective debts of the group exceeded $1 billion, much of which will never be repaid.[387]

In addition to the Bennett Funding situation, numerous other bankruptcy cases have been filed in recent times involving fraudulent transfer attacks in connection with failed Ponzi schemes.[388]

Defendant-investors have raised several defenses to a fraudulent transfer claim with varying degrees of success. For example, some investors have argued that the trustee cannot establish that the transfer was "of an interest of the debtor in property," one of the elements necessary to establish a fraudulent transfer claim. The argument by these investors is that the property transferred by the debtor to the investor was obtained by the debtor through a fraud on other investors, and therefore, the debtor never actually obtained title to the funds.[389] Courts have generally held that the debtor has an interest in funds obtained from investors in a Ponzi scheme, and thus such a defense is not available.[390] The few courts that have allowed the defense have done so *only* when the Ponzi-investor can establish that the funds he received were the same funds that the Ponzi-investor invested in the debtor.[391]

Another defense raised by investor-defendants is based on the fact that the transfers received from the debtor generally come in one of two forms: Transfers can be a return of principal or a profit on the initial investment. Most courts have held that a debtor does receive equivalent value for the return of an investor's original principal investment, and therefore, such a transfer cannot be recovered as a fraudulent transfer.[392] Courts have almost unanimously held that the debtor does *not* receive reasonably equivalent value for any amount received in excess of the original investment thereby subjecting such amounts to fraudulent transfer attack.[393]

REMEDIES FOR THE RECOVERY OF FRAUDULENT TRANSFERS

Once a transfer has been determined to be fraudulent, the property that was transferred or the value of it can be recovered from the recipient. Section 550(a) of the Bankruptcy Code covers the liability for avoided transfers and, in pertinent part, provides:

> the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.[394]

The Bankruptcy Code does not define the terms "initial transferee," "immediate transferee," or "mediate transferee." In general, the party that receives the transfer or property *directly* from the debtor is the initial transferee.[395] Courts have used the "dominion or control" test to determine whether a recipient of funds is an "initial transferee" under Section 550.[396] Under the dominion or control test, a party is not considered an initial transferee of a transfer received directly from the debtor unless that party gains actual dominion or control over the funds.[397] When an intermediary party receives but does not gain actual dominion or control over the funds, that party is considered a mere conduit or agent for one of the real parties to the transaction.[398] Dominion or control over money or an asset means having the right to put the money to one's own use for whatever purpose the recipient so desires.[399] As explained by the Eleventh Circuit Court of Appeals, the application of the dominion or control test requires the court to "step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable."[400]

Fraudulent transfer defendants have been found to be an "initial transferee" when:

- The entity, a lender, received transfers from a corporate debtor guarantor upon instructions by insiders to apply the transfers to reduce the insider's debt to the lender because the lender was the only party to exercise control over funds immediately after they were transferred by the debtor.[401]
- The entity was the beneficiary of the trust fund which received the initial transfer.[402]
- The entity was the lessor of the debtor who received payment for rent arrearage as a precondition to giving a new lease to the purchaser of the debtor's business.[403]
- The entity retained a portion of the payment as its fee (at least as to the portion of the property transferred).[404]
- The entity was a shell corporation through which selling shareholders in a leveraged buyout were paid.[405]

The court in *Bonded Financial Services, Inc. v. European American Bank*[406] held that the defendant bank acted as a "mere conduit" when it handled the debtor's check, payable to the defendant's order with a note directing the defendant bank to deposit the check into another account.[407] The court explained that, even though the bank was the payee on the check, it acted only as a financial intermediary and received no benefit.[408] Similarly, a law firm holding its client's funds in escrow has been held to be a mere conduit.[409] Several other courts, however, have adopted a slightly different approach from that of the *Bonded Financial* court. These other courts have relied on equitable factors, such as good faith and lack of knowledge, in addition to lack of benefit received, to determine if an initial transferee is liable or just a conduit.[410]

The UFCA, UFTA, and Section 548 of the Bankruptcy Code provide some protection to good faith purchasers for value. Section 550(b) of the Bankruptcy Code provides that if an immediate or mediate transferee takes "for value, . . . in good faith, and without knowledge of the voidablity of the transfer," the trustee or debtor-in-possession may not recover the property or its value from such immediate or mediate "good faith transferee."[411] The trustee also may not recover the property or its value from a subsequent good faith transferee.[412] Congress

has explained that the "good faith" requirement of Section 550 is intended to preclude a transferee (from whom the trustee can recover the property) from "laundering" or "washing" the property through an innocent third party.[413]

In *Davis v. Cook Construction Co. (In re SLF News Distributors, Inc.)*,[414] the court held that a fraudulent transfer defendant, who had released a mechanic's lien in exchange for a $10,000 certified check without knowledge that the funds actually came from an insolvent debtor rather than from the entity who actually owed the money, was a protected, good faith, secondary transferee. Accordingly, the trustee could not recover the $10,000 from the defendant.

Sometimes courts will give a good faith transferee credit for amounts previously paid if the court determines that the good faith transferee did not pay "full" value. In *Burtrum v. Laughlin (In re Laughlin)*,[415] the Laughlins transferred a piece of real property valued at $40,000 to their son for $1, and he then sold the property, subject to a $12,000 lien, to the Millers for $5,000. The court explained that the transfer from the Laughlins to their son for $1 was unquestionably an avoidable fraudulent conveyance.[416] Yet because the Millers took the property in good faith for value, they qualified as good faith transferees. Accordingly, the court gave the Millers the option either to (i) return the property to the trustee, subject to a lien for the $5,000 they paid for the property, or (ii) pay the trustee the fair market value of the property, less the $5,000 they had previously paid.

CORPORATE ACTORS/INDIVIDUAL LIABILITY

Once a defrauded creditor has exhausted its remedies in bankruptcy and remains unpaid, it still may have options available to it. While fraud claims have no greater priority in bankruptcy than general unsecured claims, individual debtors may be denied a discharge in bankruptcy as to some or all of their debts where fraud exists. A corporation only gets a discharge by confirmation of a plan of reorganization. Notwithstanding the lack of a discharge in bankruptcy, actual collection from individuals or corporations is another story. An insolvent corporation, in or out of bankruptcy, may simply liquidate its assets and cease to exist. Individuals may attempt to make themselves "judgment proof" by refusing to accumulate assets postbankruptcy (at least none that can be used to satisfy claims). In either situation, fraud victims may need to look to other solvent third parties to obtain payment. Transferees (or advisors of transferees) of fraudulent transfers, as discussed, are in such a group. In a corporate context, there may be the ability to pursue shareholders, officers, or directors, on a variety of theories. These theories may provide alternate avenues for recovery where the debtor has insufficient assets to satisfy fraud claims.

Personal Liability for Fraud

If a creditor has been defrauded, one obvious and direct avenue of recovery is to sue the individual person who committed the fraud. Persons are liable for their own fraudulent behavior.[417] As a general rule, officers and directors "are personally liable for these torts which they personally commit . . . even though performed in the name of an artificial body."[418] Since fraud is a tort, officers and directors will face personal liability for fraudulent actions that they commit, even if the actions are made on behalf of a corporation.[419] This may provide creditors with a direct avenue of recovery where, as often is the case, the corporation does not have sufficient assets to satisfy the claim.

Piercing the Corporate Veil

Creditors of a corporation may also seek to "pierce the corporate veil." Under this method of recovery, a creditor can pursue a claim directly against the shareholders normally protected from liability by the corporation for any claims against the corporation, including fraud claims. A claim to pierce the corporate veil is akin to a claim of fraud, as it is an allegation that the corporate shell is being used to hide or disguise the real identity of the debtor and its activities to defraud creditors.

In order to successfully pierce the corporate veil, a creditor must show that the shareholder abused the legal separation of corporation from owner and that the shareholder abused the corporation for illegitimate purposes:[420]

> In determining whether to pierce the corporate veil and find an alter ego, the court considers: (1) gross undercapitalization; (2) failure to observe corporate formalities; (3) non-payment of dividends; (4) insolvency of the debtor corporation; (5) siphoning of funds by the dominant shareholder; (6) non-functioning of other officers and directors; (7) absence of corporate records; and (8) the fact that the corporation is a mere façade for the operations of the dominant stockholder.[421]

The plaintiff has the burden of showing liability by "clear and convincing evidence."[422]

One example of a case where a defrauded creditor was able to pierce the corporate veil successfully was *Cantiere DiPortovenere Piesse S.p.A. v. Kerwin*.[423] In *Kerwin,* the plaintiff/creditor previously obtained a judgment against NRG in the amount of $190,981.33. Jerome Kerwin was the sole shareholder of NRG, and his wife, Helen Kerwin, was an officer of NRG. The plaintiff, after discovering that NRG was insolvent, sought to pierce the corporate veil and hold the Kerwins liable for the debt of NRG. The plaintiff alleged that NRG was a sham corporation, that the Kerwins exercised total control over NRG, and that they had rendered NRG insolvent by plundering and converting corporate assets. On a motion for new trial, the district court found that expert testimony established that the Kerwins had disregarded the corporate formalities of NRG. The court also ruled that proof of fraud was not required in order to pierce the corporate veil.[424]

Breach of Fiduciary Duty

Breach of fiduciary actions also often arise in the context of fraudulent transfers. Officers and directors of a corporation need to be aware that they may potentially be exposed to individual liability for actions that are undertaken when the corporation is insolvent or operating in the zone of insolvency.

In the event that the corporation fraudulently transfers assets, the directors may also be exposed to a claim for breach of fiduciary duty. Courts that have addressed this issue have found that personal liability extends for breach of fiduciary duty to directors, officers, and even to those individuals (i.e., lower-level corporate employees) who aid, abet, or conspire to commit the fraudulent transfer.[425]

Insolvency for a corporation is defined under the Bankruptcy Code as a financial condition such that the sum of an entity's debts is greater than all of its assets.[426] Under general corporate law, in a solvent corporation, directors owe a fiduciary duty to the shareholders of the corporation. Courts have taken the position, however, that the directors of an insolvent corporation owe a fiduciary duty to the corporation's *creditors*.[427] The rationale for this change is that the business decisions made by the officers and directors of an insolvent corporation directly affect the creditors.[428]

> The general rule is that directors do not owe creditors duties beyond the relevant contractual terms absent "special circumstances . . . e.g., . . . insolvency . . . ." When the insolvency exception does arise, it creates fiduciary duties for directors for the benefit of creditors.
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> The economic rationale for the "insolvency exception" is that the value of creditors' contract claims against an insolvent corporation may be affected by the business decisions of managers. At the same time, the claims of the shareholders are (at least temporarily) worthless. As a result it is the creditors who "now occupy the position of residual owners."[429]

If the corporation is insolvent, the directors essentially become trustees for the corporation's creditors and hold the corporate assets in trust for the benefit of the corporation's creditors.[430] The directors owe a fiduciary duty not to deplete the corporate assets to the disadvantage of creditors. Thus, directors face broadened duties when a corporation is operating in the vicinity of insolvency that may expose them personally.[431]

In *Flegel v. Burt & Assoc., P.C. (In re Kallmeyer)*,[432] the debtor was a physician who formed a corporation, NIM, that provided patient and billing services. The debtor was the sole director, officer, and shareholder of NIM. A creditor sued NIM for unpaid legal fees. Following NIM's entry into insolvency, the debtor filed for bankruptcy, and the creditor sought to have the debt owed to it declared nondischargeable pursuant to Section 523(a)(4). The creditor alleged that the debtor breached her fiduciary duty to it after NIM transferred $71,800 to the debtor as a shareholder.

The court found that the debtor, as a director of NIM, owed a fiduciary duty to the creditor.[433] Thus, the debtor, as a director, had a shifting fiduciary duty to preserve NIM's assets for the benefit of its creditors. By facilitating the transfer of money from NIM to its shareholders while NIM was insolvent, the debtor breached her fiduciary duty to the creditor and committed a defalcation, rendering the debt nondischargeable under Section 523(a)(4).

Aiding and Abetting Fraudulent Transfers

Courts have recognized a cause of action for aiding and abetting a fraudulent transfer. Thus, in addition to pursuing fraudulent transfer claims, creditors who have been defrauded have also attempted to collect from a debtor's professionals, such as attorneys and accountants, under a theory that they aided and abetted the corporation in making a fraudulent transfer. This is a powerful tool for creditors. Currently it is not clear whether attorneys or accountants may be liable for aiding and abetting their clients to commit fraud based on their counsel and advice. Regardless of any potential liability under an aiding and abetting claim, attorneys and accountants would still be liable for any personal acts of fraud which they commit.

The issue of whether a cause of action exists for aiding and abetting a fraudulent transfer arose recently in the Illinois case of *Coleman v. Greenfield*.[434] In *Coleman,* the court concluded that under Illinois law a cause of action for aiding and abetting a fraudulent transfer does exist.[435]

In *Coleman,* the plaintiff filed a 10-count complaint seeking to enforce a judgment obtained against affiliates of the defendant. The plaintiff had previously obtained a $954,028.60 judgment against Bar Louie Tempe, Inc. and a $488,604.20 judgment against Restaurant Development Group ("RDG"). Roger Greenfield and Theodore Kasemir were the officers, directors and sole shareholders of both RDG and Bar Louis Tempe. In the complaint, the plaintiff alleged that Greenfield and Kasemir, in an effort to avoid paying the judgment, caused RDG to transfer

certain of the defendants' assets for no consideration. Subsequently, RDG ceased its business operations. In the complaint the plaintiff sought to avoid the alleged fraudulent transfers. Additionally, one count of the 10-count complaint alleged a charge of aiding and abetting a fraudulent transfer. The defendants sought to dismiss the aiding and abetting count asserting that under Illinois law there was no separate count for aiding and abetting. The *Coleman* court noted that the United States Seventh Circuit Court of Appeals previously stated that aiding and abetting was essentially the basis for imposing liability for the tort and was not in and of itself a separate tort.[436] The *Coleman* court went on to acknowledge that since the Seventh Circuit's holding in *Eastern Trading Co. v. Lefco, Inc.*,[437] courts have recognized a separate cause of action for aiding and abetting.[438] Specifically, the court cited *Thornwood, Inc. v. Jenner & Block*,[439] which recognized a claim for aiding and abetting fraud and aiding and abetting a breach of fiduciary duty.[440] The court also noted the recent opinion from *In re Parmalat Security Litigation*,[441] in which the court recognized a separate claim for aiding and abetting.[442] The *Coleman* court elected to follow this decision and stated that there was a separate claim for aiding and abetting and, thus, denied the defendant's motion to dismiss the count.[443]

Significantly, the court went on to state that it believed that any discussion of this issue was essentially academic because the:

> Seventh Circuit and the intermediate Illinois courts agree that knowingly assisting another to commit fraud gives rise to civil liability under Illinois law; they simply disagree as to whether such count should be called "fraud" or "aiding and abetting fraud."[444]

The Florida Supreme Court, however, reached a different conclusion on the aiding and abetting issue. In *Freeman v. First Union National Bank*,[445] the Florida Supreme Court unanimously ruled that there is not a cause of action for aiding and abetting a fraudulent transfer when the alleged aider and abettor was not the transferee.[446]

In *Freeman*, creditors brought suit against First Union National Bank ("First Union") for First Union's role in an alleged Ponzi scheme conducted by Unique Gems ("Unique").[447] Following the commencement of the lawsuit, a court order freezing Unique's assets, including certain funds in its account with First Union, was entered by the court.[448]

After the freeze, Unique allegedly wire-transferred approximately $6.6 million from its First Union account to a third party. Following the wire transfer, the plaintiffs sued First Union, alleging that First Union was liable for money damages on the legal theory that it aided and abetted a fraudulent transfer by allowing Unique to transfer the funds from its First Union account. The district court dismissed the claim with prejudice, citing the failure to state a cause of action under Florida law for the aiding and abetting claim.[449]

On appeal, the United States Eleventh Circuit Court of Appeals held that the Florida UFTA differs from Section 548 of the Bankruptcy Code because it includes a "catch-all" phrase providing for any other relief the circumstances may require.[450] Thus, the Eleventh Circuit certified a question for Florida's Supreme Court regarding whether the Florida UFTA created a cause of action for damages in favor of a creditor against an aider or abettor to a fraudulent transaction.[451]

The issue posed to the Florida Supreme Court was whether the Florida UFTA remedies, like the remedies available under Section 548, include only equitable powers to avoid the fraudulent transfer or whether the additional language of "any other relief the circumstances require" gives rise to a common law claim against a third party who aided or abetted the fraudulent transfer. In its opinion, the Florida Supreme Court concluded:

> On the face of the statute, there is no ambiguity with respect to whether FUFTA creates an independent cause of action for aiding and abetting liability. There is simply no language in FUFTA that suggests the creation of a distinct cause of action for aiding-abetting claims against non-transferees. Rather, it appears that FUFTA was intended to codify an existing but imprecise system whereby transfers that were intended to defraud creditors be set aside.
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> To adopt the appellants' position in this case would be to expand the FUFTA beyond its facial application and in a manner that is outside the purpose and plain language of the statute. Consistent with this analysis we conclude that the FUFTA was not intended to serve as a vehicle by which a creditor may bring a suit against a non-transferee party (like First Union in this case) for monetary damages arising from the non-transferee party's alleged aiding and abetting of a fraudulent money transfer.[452]

Based on the recent decisions from *Coleman* and *Freeman,* the resolution of the issue of whether a claim can exist for aiding and abetting a fraudulent transfer is unclear. Attorneys, accountants, and other professionals advising corporations and individuals need to be aware of potential exposure for fraudulent transfers and understand that even though they may not have personally committed fraud, they can be held liable. While the facts in neither *Coleman* nor *Freeman* involved attorneys or accountants, the legal arguments raised by the defrauded creditors can similarly be asserted by a defrauded creditor against an attorney or accountant that facilitated a fraudulent transfer of assets. Professionals should be aware of potential personal liability with respect to the advice and counsel they provide their clients.

CONCLUSION

The advent of the Bankruptcy Abuse Act represents the latest significant effort to deter and remedy fraudulent acts, whether occurring prior to or in connection with the bankruptcy process. Even absent the promulgation of this act, modern business practices, the evolution of transaction structures, and heightened media attention on high-profile bankruptcy cases have all caused increased scrutiny of conduct that may be challenged as fraudulent.

While not involving bankruptcy fraud per se, the legacy of recent major Chapter 11 cases, such as Enron and WorldCom, is that the improper business practices exposed by those cases, and related investigations and proceedings, have fostered an unprecedented cynical view of corporate America and the ethics of modern American businesspeople. As a result, the scope of legislation and court activism to address fraudulent conduct has reached a new zenith.

For businesses, businesspeople, and their professional advisors, it is more essential than ever to be vigilant in knowing the legal parameters that circumscribe appropriate conduct. Nowhere is this truer than in bankruptcy, where the net has been cast to a wider extent than ever to address perceived fraud, both actual and constructive. In an increasingly aggressive and litigious American business community, no one is immune from attack. Two things, however, appear clear:

1. There have never existed better legal tools to pursue claims in bankruptcy against bad actors who have engaged in fraudulent acts and transactions.
2. Even businesses and businesspeople who act in good faith may find themselves subject to claims if they are ignorant of the laws and legal theories that govern their conduct and transactions.

APPENDIX 17A

Uniform Fraudulent Conveyance Act and Uniform Fraudulent Transfer Act

Uniform Fraudulent Conveyance Act	
State	**Statutory Reference**
Maryland	Code, Commercial Law, §§ 15-201 to 15-214
New York	McKinney's Debtor and Creditor Law, §§ 270 to 281
Virgin Islands	28 V.I.C. §§ 201 to 212
Wyoming	Wyo. Stat. Ann. §§ 34-14-101 to 34-14-113

Uniform Fraudulent Transfer Act	
State	**Statutory Reference**
Alabama	Code 1975, §§ 8–9A–1 to 8–9A–12
Arizona	A.R.S. §§ 44–1001 to 44–1010
Arkansas	A.C.A. §§ 4–59–201 to 4–59–213
California	West's Ann. Cal. Civ. Code, §§ 3439 to 3439.12
Colorado	West's C.R.S.A. §§ 38–8–101 38–8–112
Connecticut	C.G.S.A. §§ 52–552a to 52-5521
Delaware	6 Del. C. §§ 1301 to 1311
District of Columbia	D.C. Official Code, 2001 Ed. §§ 11–160
Florida	West's F.S.A. §§ 726.101 to 726–112
Georgia	O.C.G.A. §§ 18–2–70 to 18–2–80
Hawaii	HRS §§ 651C–1 to 651C–10
Idaho I.C.	§§ 55–910 to 55–921
Illinois	S.H.A. 740 ILCS 160/1 to 160/12.86–814
Indiana	West's A.I.C. 32-18-2-1 to 32-18-2-21
Iowa	I.C.A. §§ 684.1 to 684.12
Kansas	K.S.A. 33–201 to 33–212
Maine	14 M.R.S.A. §§ 3571 to 3582
Massachusetts	M.G.L.A. c. 109A, §§ 1 to 12
Michigan	M.C.L.A. §§ 566.31 to 566.43
Minnesota	M.S.A. §§ 513.41 to 513.51
Missouri	V.A.M.S. §§ 428.005 to 428.059
Montana	MCA 31–2–326 to 31–2-342

Uniform Fraudulent Transfer Act *(Continued)*

State	Statutory Reference
Nebraska	R.R.S. 1943, §§ 36-701 to 36-712
Nevada	N.R.S. 112.140 to 112.250
New Hampshire	RSA 545-A:1 to 545-A:12. 215
New Jersey	N.J.S.A. 25:2-20 to 25:2-34
New Mexico	NMSA 1978, §§ 56-10-14 to 56-10-25
North Carolina	G.S. §§ 39-23.1 to 39-23.12
North Dakota	NDCC 13-02.1-01 to 13-02.1-10
Ohio	R.C. §§ 1336.01 to 1336.11
Oklahoma	24 Okl. St. Ann. §§ 112 to 123
Oregon	ORS 95.200 to 95.310
Pennsylvania	12 Pa. C.S.A. §§ 5101 to 5110
Rhode Island	Gen. Laws 1956, §§ 6-16-1 to 6-16-12
South Dakota	SDCL 54-8A-1 to 54-8A-12
Tennessee	T.C.A. §§ 66-3-301 to 66-3-313
Texas	V.T.C.A. Bus. & C. §§ 24.001 to 24.013
Utah	U.C.A. 1953, 25-6-1 to 25-6-14
Vermont	9 V.S.A. §§ 2285 to 2295
Washington	West's RCWA 19.40.011 to 19.40.903
West Virginia	Code, 40-1A-1 to 40-1A-12
Wisconsin	W.S.A. 242.01 to 242.11

APPENDIX 17B

Uniform Fraudulent Conveyance Act

§ 1. Definition of Terms.

In this act "Assets" of a debtor means property not exempt from liability for his debts. To the extent that any property is liable for any debts of the debtor, such property shall be included in his assets.

"Conveyance" includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or encumbrance.

"Creditor" is a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

"Debt" includes any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

§ 2. Insolvency.

(1) A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured.

(2) In determining whether a partnership is insolvent there shall be added to the partnership property the present fair salable value of the separate assets of each general partner in excess of the amount probably sufficient to meet the claims of his separate creditors, and also the amount of any unpaid subscription to the partnership of each limited partner, provided the present fair salable value of the assets of such limited partner is probably sufficient to pay his debts, including such unpaid subscription.

§ 3. Fair Consideration.

Fair consideration is given for property, or obligation:

(a) When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or

(b) When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

§ 4. Conveyances by Insolvent.

Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

§ 5. Conveyances by Persons in Business.

Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.

§ 6. Conveyances by a Person about to Incur Debts.

Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

§ 7. Conveyance Made with Intent to Defraud.

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.

§ 8. Conveyance of Partnership Property.

Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred:

(a) To a partner, whether with or without a promise by him to pay partnership debts, or

(b) To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners.

§ 9. Rights of Creditors Whose Claims Have Matured.

(1) Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser:

(a) Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim, or

(b) Disregard the conveyance and attach or levy execution upon the property conveyed.

(2) A purchaser who without actual fraudulent intent has given less than a fair consideration for the conveyance or obligation, may retain the property or obligation as security for repayment.

§ 10. Rights of Creditors Whose Claims Have Not Matured.

Where a conveyance made or obligation incurred is fraudulent as to a creditor whose claim has not matured he may proceed in a court of competent jurisdiction against any person against whom he could have proceeded had his claim matured, and the court may:

(a) Restrain the defendant from disposing of his property,

(b) Appoint a receiver to take charge of the property.

(c) Set aside the conveyance or annul the obligation, or

(d) Make any order which the circumstances of the case may require.

APPENDIX 17C

Uniform Fraudulent Transfer Act

§ 1. Definitions.

As used in this [Act]:

(1) "Affiliate" means:

(i) a person who directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole discretionary power to vote the securities; or

(B) solely to secure a debt, if the person has not exercised the power to vote;

(ii) a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor or a person who directly or indirectly owns, controls, or holds, with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole power to vote the securities; or

(B) solely to secure a debt, if the person has not in fact exercised the power to vote;

(iii) a person whose business is operated by the debtor under a lease or other agreement, or a person substantially all of whose assets are controlled by the debtor; or

(iv) a person who operates the debtor's business under a lease or other agreement or controls substantially all of the debtor's assets.

(2) "Asset" means property of a debtor, but the term does not include:

(i) property to the extent it is encumbered by a valid lien;

(ii) property to the extent it is generally exempt under nonbankruptcy law; or

(iii) an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant.

(3) "Claim" means a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

(4) "Creditor" means a person who has a claim.

(5) "Debt" means liability on a claim.

(6) "Debtor" means a person who is liable on a claim.

(7) "Insider" includes:

(i) if the debtor is an individual,

(A) a relative of the debtor or of a general partner of the debtor;

(B) a partnership in which the debtor is a general partner;

(C) a general partner in a partnership described in clause (B); or

(D) a corporation of which the debtor is a director, officer, or person in control;

(ii) if the debtor is a corporation,
  (A) a director of the debtor;
  (B) an officer of the debtor;
  (C) a person in control of the debtor;
  (D) a partnership in which the debtor is a general partner;
  (E) a general partner in a partnership described in clause (D); or
  (F) a relative of a general partner, director, officer, or person in control of the debtor;

(iii) if the debtor is a partnership,
  (A) a general partner in the debtor;
  (B) a relative of a general partner in, a general partner of, or a person in control of the debtor;
  (C) another partnership in which the debtor is a general partner;
  (D) a general partner in a partnership described in clause (C); or
  (E) a person in control of the debtor;

(iv) an affiliate, or an insider of an affiliate as if the affiliate were the debtor; and

(v) a managing agent of the debtor.

(8) "Lien" means a charge against or an interest in property to secure payment of a debt or performance of an obligation, and includes a security interest created by agreement, a judicial lien obtained by legal or equitable process or proceedings, a common-law lien, or a statutory lien.

(9) "Person" means an individual, partnership, corporation, association, organization, government or governmental subdivision or agency, business trust, estate, trust, or any other legal or commercial entity.

(10) "Property" means anything that may be the subject of ownership.

(11) "Relative" means an individual related by consanguinity within the third degree as determined by the common law, a spouse, or an individual related to a spouse within the third degree as so determined, and includes an individual in an adoptive relationship within the third degree.

(12) "Transfer" means 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, and includes payment of money, release, lease, and creation of a lien or other encumbrance.

(13) "Valid lien" means a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.

§ 2. Insolvency.

(a) A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation.

(b) A debtor who is generally not paying his [or her] debts as they become due is presumed to be insolvent.

(c) A partnership is insolvent under subsection (a) if the sum of the partnership's debts is greater than the aggregate, at a fair valuation, of all of the partnership's assets and the sum of the excess of the value of each general partner's nonpartnership assets over the partner's nonpartnership debts.

(d) Assets under this section do not include property that has been transferred, concealed, or removed with intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer voidable under this [Act].

(c) Debts under this section do not include an obligation to the extent it is secured by a valid lien on property of the debtor not included as an asset.

§ 3. Value.

(a) 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, but 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.

(b) For the purposes of Sections 4(a)(2) and 5, a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

(c) A transfer is made for present value if the exchange between the debtor and the transferee is intended by them to be contemporaneous and is in fact substantially contemporaneous.

§ 4. Transfers Fraudulent as to Present and Future Creditors.

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

(1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or

(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.

(b) In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

(1) the transfer or obligation was to an insider;

(2) the debtor retained possession or control of the property transferred after the transfer;

(3) the transfer or obligation was disclosed or concealed;

(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) the transfer was of substantially all the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed assets;

(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

§ 5. Transfers Fraudulent as to Present Creditors.

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

(b) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

§ 6. When Transfer is Made or Obligation Is Incurred.

For the purposes of this [Act]:

(1) a transfer is made:

(i) with respect to an asset that is real property other than a fixture, but including the interest of a seller or purchaser under a contract for the sale of the asset, when the transfer is so far perfected that a good-faith purchaser of the asset from the debtor against whom applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee; and

(ii) with respect to an asset that is not real property or that is a fixture, when the transfer is so far perfected that a creditor on a simple contract cannot acquire a judicial lien otherwise than under this [Act] that is superior to the interest of the transferee;

(2) if applicable law permits the transfer to be perfected as provided in paragraph (1) and the transfer is not so perfected before the commencement of an action for relief under this [Act], the transfer is deemed made immediately before the commencement of the action;

(3) if applicable law does not permit the transfer to be perfected as provided in paragraph (1), the transfer is made when it becomes effective between the debtor and the transferee;

(4) a transfer is not made until the debtor has acquired rights in the asset transferred;

(5) an obligation is incurred:

(i) if oral, when it becomes effective between the parties; or

(ii) if evidenced by a writing, when the writing executed by the obligor is delivered to or for the benefit of the obligee.

§ 7. Remedies of Creditors.

(a) In an action for relief against a transfer or obligation under this [Act], a creditor, subject to the limitations in Section 8, may obtain:

(1) avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim;

(2) an attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by [ ]

(3) subject to applicable principles of equity and in accordance with applicable rules of civil procedure,

(i) an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;

(ii) appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or

(iii) any other relief the circumstances may require.

(b) If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.

§ 8. Defenses, Liability, and Protection of Transferee.

(a) A transfer or obligation is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee.

(b) Except as otherwise provided in this section, to the extent a transfer is voidable in an action by a creditor under Section 7(a)(1), the creditor may recover judgment for the value of the asset transferred, as adjusted under subsection (c), or the amount necessary to satisfy the creditor's claim, whichever is less. The judgment may be entered against:

(1) the first transferee of the asset or the person for whose benefit the transfer was made; or

(2) any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee.

(c) If the judgment under subsection (b) is based upon the value of the asset transferred, the judgment must be for an amount equal to the value of the asset at the time of the transfer, subject to adjustment as the equities may require.

(d) Notwithstanding voidability of a transfer or an obligation under this [Act], a good-faith transferee or obligee is entitled, to the extent of the value given the debtor for the transfer or obligation, to

(1) a lien on or a right to retain any interest in the asset transferred;

(2) enforcement of any obligation incurred; or

(3) a reduction in the amount of the liability on the judgment.

(e) A transfer is not voidable under Section 4(a)(2) or Section 5 if the transfer results from:

(1) termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law; or

(2) enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code.

(f) A transfer is not voidable under Section 5(b):

(1) to the extent the insider gave new value to or for the benefit of the debtor after the transfer was made unless the new value was secured by a valid lien;

(2) if made in the ordinary course of business or financial affairs of the debtor and the insider; or

(3) if made pursuant to a good-faith effort to rehabilitate the debtor and the transfer secured present value given for that purpose as well as an antecedent debt of the debtor.

§ 9. Extinguishment of [Claim for Relief] [Cause of Action].

A [claim for relief] [cause of action] with respect to a fraudulent transfer or obligation under this [Act] is extinguished unless action is brought:

(a) under Section 4(a)(1), within 4 years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant;

(b) under Section 4(a)(2) or 5(a), within 4 years after the transfer was made or the obligation was incurred; or

(c) under Section 5(b), within one year after the transfer was made or the obligation was incurred.

§ 10. Supplementary Provisions.

Unless displaced by the provisions of this [Act], the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement its provisions.

Appendix 17D

18 U.S.C. §§ 152–157

18 U.S.C. § 152. Concealment of Assets; False Oaths and Claims; Bribery.

A person who—

(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor;

(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;

(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under Section 1746 of title 28, in or in relation to any case under title 11;

(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;

(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;

(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;

(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation;

(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor; or

(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustees entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor,

shall be fined under this title, imprisoned not more than 5 years, or both.

18 U.S.C. § 153. Embezzlement against estate.

(a) OFFENSE. A person described in subsection (b) who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both.

(b) PERSON TO WHOM SECTION APPLIES. A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such an officer to perform a service with respect to the estate.

18 U.S.C. § 154. Adverse interest and conduct of officers.

A person who, being a custodian, trustee, marshal, or other officer of the court—

knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;

knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; or

knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge, shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant.

18 U.S.C. § 155. Fee agreements in cases under title 11 and receiverships.

Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in interest, in any receivership or case under Title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate shall be fined under this title or imprisoned not more than one year, or both.

18 U.S.C. § 156. Knowing disregard of bankruptcy law or rule.

DEFINITIONS. In this section—

(1) the term "bankruptcy petition preparer" means a person, other than the debtor's attorney or any employee of such an attorney, who prepares for compensation a document for filing; and

(2) the term "document for filing" means a petition or any other documents prepared for filing by a debtor in the United States bankruptcy court or a United States district court in connection with a case under Title 11.

(b) OFFENSE. If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of Title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title, imprisoned not more than 1 year, or both.

18 U.S.C. § 157. Bankruptcy fraud.

A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so—

(1) files a petition under Title 11, including a fraudulent involuntary bankruptcy petition under Section 303 of such title;

(2) files a document in a proceeding under Title 11, including a fraudulent involuntary bankruptcy petition under Section 303 of such title; or

(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under Title 11, including a fraudulent involuntary bankruptcy petition under Section 303 of such title, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title,

shall be fined under this title, imprisoned not more than 5 years, or both

Appendix 17E

11 U.S.C. § 548. Fraudulent Transfers and Obligations

(a) (1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

(2) A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which—

(A) the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made; or

(B) the contribution made by a debtor exceeded the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

(b) The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under Section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d) (1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

(2) In this section—

(A) "value" means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor;

(B) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency that receives a margin payment, as defined in Section 101, 741, or 761 of this title, or settlement payment, as defined in Section 101 or 741 of this title, takes for value to the extent of such payment;

(C) a repo participant or financial participant that receives a margin payment, as defined in Section 741 or 761 of this title. or settlement payment, as defined in Section 741 of this title, in connection with a repurchase agreement, takes for value to the extent of such payment;

(D) a swap participant or financial participant that receives a transfer in connection with a swap agreement takes for value to the extent of such transfer; and

(E) a master netting agreement participant that receives a transfer in connection with a master netting agreement or any individual contract covered thereby takes for value to the extent of such transfer, except that, with respect to a transfer under any individual contract covered thereby, to the extent that such master netting agreement participant otherwise did not take (or is otherwise not deemed to have taken) such transfer for value.

(3) In this section, the term "charitable contribution" means a charitable contribution, as that term is defined in Section 170(c) of the Internal Revenue Code of 1986, if that contribution—

(A) is made by a natural person; and

(B) consists of—

(i) a financial instrument (as that term is defined in Section 731(c)(2)(C) of the Internal Revenue Code of 1986); or

(ii) cash.

(4) In this section, the term "qualified religious or charitable entity or organization" means—

(A) an entity described in Section 170(c)(1) of the Internal Revenue Code of 1986; or

(B) an entity or organization described in Section 170(c)(2) of the Internal Revenue Code of 1986.

(e) (1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition if—

(A) such transfer was made to a self-settled trust or similar device;

(B) such transfer was by the debtor;

(C) the debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

(2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by—

(A) any violation of the securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or

(B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under Section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l and 78o(d)) or under Section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

APPENDIX 17F

11 U.S.C. § 522 Exemptions

11 U.S.C. § 522(d).

The following property may be exempted under subsection (b)(2) of this section:

(1) The debtor's aggregate interest, not to exceed $18,450 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(2) The debtor's interest, not to exceed $2,950 in value, in one motor vehicle.

(3) The debtor's interest, not to exceed $475 in value in any particular item or $9,850 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $1,225 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(5) The debtor's aggregate interest in any property, not to exceed in value $975 plus up to $9,250 of any unused amount of the exemption provided under paragraph (1) of this subsection.

(6) The debtor's aggregate interest, not to exceed $1,850 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

(7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.

(8) The debtor's aggregate interest, not to exceed in value $9,850 less any amount of property of the estate transferred in the manner specified in Section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.

(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

(10) The debtor's right to receive—

(A) a social security benefit, unemployment compensation, or a local public assistance benefit;

(B) a veterans' benefit;

(C) a disability, illness, or unemployment benefit;

(D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extend reasonably necessary for the support of the debtor and any dependent of the debtor, unless -

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under Section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986.

(11) The debtor's right to receive, or property that is traceable to—

(A) an award under a crime victim's reparation law;

(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed $18,450, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

(12) Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under Section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

11 U.S.C. § 522(o).

For purposes of subjection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in—

(1) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

(3) a burial plot for the debtor or a dependent of the debtor; or

real or personal property that the debtor or a dependent of the debtor claims as a homestead,

shall be reduced to the extend that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

11 U.S.C. § 522(p).

(1) Except as provided in paragraph (2) of this subsection and Sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in—

(A) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

(C) a burial plot for the debtor or a dependent of the debtor; or

(D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

(2) (A) The limitation under paragraph (1) shall not apply to an exemption claimed under subsection (b)(3)(A) by a family farmer for the principal residence of such farmer.

For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the

beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

11 U.S.C. § 522(q).

(1) As a result of electing under subsection (b)(3)(A) to exempt property under State of local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate $125,000 if—

(A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in Section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or

(B) the debtor owes a debt arising from—

any violation of the Federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws;

fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under Section 12 or 15(d) of the Securities Exchange Act of 1934 or under Section 6 of the Securities Act of 1933;

any civil remedy under Section 1964 of title 18; or

any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.

(2) Paragraph (1) shall not apply to the extent the amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) is reasonably necessary for the support of the debtor and any dependent of the debtor.

APPENDIX 17G

11 U.S.C. § 101(31). Definitions

The term "insider" includes—

(A) if the debtor is an individual—
  (i) relative of the debtor or of a general partner of the debtor;
  (ii) partnership in which the debtor is a general partner;
  (iii) general partner of the debtor; or
  (iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation—
  (i) director of the debtor;
  (ii) officer of the debtor;
  (iii) person in control of the debtor;
  (iv) partnership in which the debtor is a general partner;
  (v) general partner of the debtor; or
  (vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership—
  (i) general partner in the debtor;
  (ii) relative of a general partner in, general partner of, or person in control of the debtor;
  (iii) partnership in which the debtor is a general partner;
  (iv) general partner of the debtor; or
  (v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor [defined in 11 U.S.C. § 101 (2)]; and

(F) managing agent of the debtor.

NOTES

1. White House Press Release (April 20, 2005).
2. The intent of the Bankruptcy Reform Act is evidenced right from the title, which is "The Bankruptcy Abuse and Prevention Act of 2005."
3. Martin H. Pritikin, "Toward Coherence in Civil Conspiracy Law: A Proposal to Abolish the Agent's Immunity Rule." *84 Neb. L. Rev. 1* (2005): 2 (*citing* "Second Interim Report of Neal Batson, Court-Appointed Examiner," *In re Enron Corp.,* No. 01-16034, 5 (Bankr. S.D. N.Y. 2003)).
4. Id.
5. 11 U.S.C. § 727(b). "A proof of claim is a written statement setting forth a creditor's claim." Fed. R. Bankr. P. § 3001(a).
6. 11 U.S.C. § 727(a)(1).
7. 11 U.S.C. § 1141.
8. 11 U.S.C. § 1328.
9. 11 U.S.C. § 727(a)(2).
10. 289 B.R. 836 (Bankr. N.D. Tex. 2003).
11. *In re Montana,* 185 B.R. 650 (Bankr. S.D. Fla. 1995).
12. 155 B.R. 782 (Bankr. M.D. Fla. 1993).
13. 11 U.S.C. § 523(a)(2).
14. False pretenses and false representation are different for purposes of exception to discharge. Money obtained by false pretenses involves an *implied* misrepresentation that is meant to create and foster a false impression, whereas a false representation involves an *express* misrepresentation. *In re Bruce.* 242 B.R. 492 (Bankr. W.D. Pa. 2001).
15. Id.
16. *In re Pleasants,* 219 F.3d 372, 375 (4th Cir. 2000).
17. *See* id.
18. 2000 U.S. Dist. LEXIS 3334 (E.D. La. 2000).
19. Id. at 12.
20. Id. at 13–14.
21. 205 B.R. 587 (Bankr. W.D. Mo. 1997).
22. 11 U.S.C. § 523(a)(2)(C)(i)(I).
23. 11 U.S.C. § 523(a)(2)(C)(i)(II).
24. 11 U.S.C. § 523(a)(4).
25. 2006 WL 771609 (Bankr. E.D. N.Y. 2006).
26. *See* "Breach of Fiduciary Duty," p. 46.
27. *Matter of Felt,* 255 F.3d 220 (5th Cir. 2001).
28. 11 U.S.C. § 1328(a)(2).
29. *St. Paul Fire & Marine Ins. Co. v. Alford* (*In re Alford*), 2003 Bankr. LEXIS 1985 (Bankr. N.D. Fla. 2003).
30. *See* Appendix 17F for the complete statutory language for 11 U.S.C. § 522.
31. *See* Collier on Bankruptcy ¶ 522.01. These states have opted out of the federal exemption system: Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming.
32. 11 U.S.C. § 522(b) and (o).
33. Id.
34. The federal exemptions are: (1) the debtor's interest, up to $18,450, in real property that the debtor uses as a homestead or a burial plot; (2) the debtor's interest, up to $2,950, in a motor vehicle; (3)

the debtor's interest, up to $475 per item and $9,850 total, in household furnishings, wearing apparel, appliances, books, animals, crops, or musical instruments; (4) the debtor's interest, up to $1,225, in jewelry; (5) the debtor's interest, up to $9,250, of any unused amount from the residence exemption under (1); (6) the debtor's interest, up to $1,850, in professional books or tools of the trade of the debtor; (7) an unmatured life insurance contract; (8) the debtor's interest, up to $9,850, in accrued interest or dividends from a life insurance contract; (9) prescribed health aids; (10) the right to social security, unemployment compensation, veterans' benefits, disability, alimony, support, or a payment from a stock bonus, pension, annuity, or similar plan; (11) the right to a crime victim award, a wrongful death payment, a life insurance payment, or a bodily injury payment; and (12) the debtor's interest in a retirement fund that is exempt from taxation.

35. 11 U.S.C. § 522(b).
36. M.C.L.A. § 600.6023(1).
37. M.C.L.A. § 600.6023(1)(h).
38. William P. Boylan and Melanie R. Beyers, "The Trek of Michigan Exemptions in the Universe of Bankruptcy," *Michigan Real Property Review* (Summer 2006).
39. 331 B.R. 267 (Bankr. E.D. Mich. 2005).
40. M.C.L.A. § 600.6023a.
41. M.C.L.A. § 600.6023a.
42. Tex. Prop. Code §§ 42.001, 42.002, and 42.003.
43. W. Va. Code §§ 38-5A-3, -9, and 38-5B-12.
44. 11 U.S.C. § 522(d)(2)
45. 11 U.S.C. § 522(d)(3).
46. 11 U.S.C. § 522(d)(10)(E).
47. 11 U.S.C. § 522(d)(12).
48. *8 Nevada Lawyer 9* (April 2000): 19 (*quoting* Restatement (Second) of Trusts § 152(2)).
49. Id.
50. *Patterson v. Shumate,* 504 U.S. 753 (1992).
51. *Compare* 11 U.S.C. § 522(d) *with* Fla. Const. art. X § 4(a)(1).
52. Fla. Const. art. X § 4(a)(1).
53. *In re Adell,* 321 B.R. 562, 572 (Bankr. M.D. Fla. 2005).
54. 151 Cong. Rec. H1993-01, 2048 § 2415-02 (2005).
55. *Adell,* 321 B.R. at 564. A bad faith bankruptcy filing is determined by the court pursuant to one of several tests: (1) the improper use test, which looks at whether the creditor used an involuntary bankruptcy to gain an unfair advantage; (2) the improper purpose test, which looks at whether the creditor sought the involuntary bankruptcy because of ill will toward the debtor; (3) the objective test, which looks at whether the creditor acted as a reasonable creditor in the situation; or (4) a test applying the Bankruptcy Rule 9011 standards. *In re Bayshore Wire Products Co.,* 209 F.3d 100 (2d Cir. 2000).
56. *Adell,* 321 B.R. at 564.
57. *In re Adell,* 310 B.R. 460, 463 (Bankr. M.D. Fl. 2004).
58. Id.
59. Id.
60. *Adell,* 321 B.R. at 565.
61. Id. at 566.
62. Id.
63. Id. at 569.
64. Id.
65. Id.
66. Id. (*citing United States v. 18755 N. Bay Rd.,* 13 F.3d 1493, 1498 (11th Cir. 1994)).
67. Id.

68. Id. at 572.
69. Id.
70. Id. at 569–70.
71. Id.
72. Id.
73. *See In re Adell,* 332 B.R. 844, 849 (Bankr. M.D. Fl. 2005).
74. *Adell,* 321 B.R. at 570.
75. *In re Maronde,* 332 B.R. 593, 597 (Bankr. D. Minn. 2005).
76. Id. at 600.
77. Id. at 598.
78. 11 U.S.C. § 522(p).
79. H.R. Rep. No. 109-31, 15–16 (2005).
80. 11 U.S.C. § 522(q).
81. 326 B.R. 785 (Bankr. D. Ariz. 2005).
82. Id. at 791.
83. Id. (emphasis added).
84. Id.
85. Id.
86. 331 B.R. 483, 488 (Bankr. S.D. Fla. 2005).
87. Id. at 487.
88. Id. at 486.
89. Id. *See also In re Virissimo,* 332 B.R. 201, 205-06 (Bankr. D. Nev. 2005) (agreeing with the *McNabb* court, finding a defect within Section 522 which created an ambiguity, and holding that the legislative history clearly demonstrated an intent for Section 522(p)(1) to apply to debtors in all states).
90. Id. at 488.
91. There are several elements to the means test. The first step is to determine if the debtor's current monthly income is greater than the median income in the debtor's state. If the answer to this threshold question is no, then the debtor can file for Chapter 7 bankruptcy protection. If the debtor's current monthly income is greater than the median income in the debtor's state, then the means test must be employed. The means test provides that *X* is equal to the debtor's current monthly income less the debtor's expenses, multiplied by 60. If *X* is $6,000.00 or less, the debtor can file a Chapter 7 bankruptcy. If *X* is 25 percent or less of unsecured debt, the debtor can file a Chapter 7 bankruptcy. If *X* is more than 25 percent of unsecured debt or is $10,000.00 or more, the debtor must file a Chapter 13 bankruptcy.
92. *6 Am. Bankr. Inst. L. Rev. 317* (Winter 1998): 320.
93. *See* Appendix 17D for the complete statutory language for 18 U.S.C. §§ 152 to 157.
94. Pub. L. 107-204 (July 30, 2002); 116 Stat. 745.
95. 18 U.S.C. § 1519.
96. *18-6 American Bankruptcy Institute Journal* (July/August 1999): 10.
97. Craig Peyton Gaumer, "Bankruptcy Fraud: Crime and Punishment." *43 S.D. L. Rev. 527* (1998): 527–28.
98. Id. at 528.
99. Id.
100. *United States v. Novak,* 217 F.3d 566, 575 (8th Cir. 2000) (*quoting United States v. Goodstein,* 883 F.2d 1362, 1369 (7th Cir. 1989); *In re May,* 12 B.R. 618, 625 (N.D. Fla. 1980).
101. 18 U.S.C. § 152(1).
102. 18 U.S.C. § 152(2).
103. 18 U.S.C. § 152(3).

104. 18 U.S.C. § 152(4).
105. 18 U.S.C. § 152(8).
106. 18 U.S.C. § 152(6).
107. *6 Am. Bankr. Inst. L. Rev. 271* (Winter 1998): 271.
108. *Beigier v. IRS,* 496 U.S. 53, 58 (1989).
109. *See* Fed. R. Bankr. P. 1007 and 1008.
110. *See* 11 U.S.C. §§ 341 and 343.
111. *United States v. Cherek,* 734 F.2d 1248, 1254 (7th Cir. 1985) (stating that 18 U.S.C. § 152 requires a debtor to discuss the existence of assets even if the immediate status of the assets is unknown).
112. *United States v. Weinstein,* 834 F.2d 1454, 1461 (9th Cir. 1987) ("The bankruptcy estate includes equitable as well as legal interests.").
113. *United States v. Moynagh,* 566 F.2d 799 (1st Cir. 1997).
114. Id. at 802–03.
115. Id. (*citing United States v. West,* 22 F.3d 586 (5th Cir. 1994)).
116. 791 F.2d 73 (7th Cir. 1986).
117. Id. at 74.
118. Id. at 75.
119. Id. at 77.
120. *United States v. Beery,* 678 F.2d 856 (10th Cir. 1982).
121. *6 Am. Bankr. Inst. L. Rev. 317* (Winter 1998): 331 (*citing United States v. Shadduck,* 112 F.3d 523, 526 (1st Cir. 1997) (using concealment of a bank account to define the elements of a Section 152 violation); *United States v. Cherek,* 734 F.2d 1248, 1252 (7th Cir. 1984) (using concealment and fraudulent intent as elements of a Section 152 violation); and *United States v. Guiliano,* 644 F.2d 85, 87 (2nd Cir. 1981) (listing a case under title 11, concealment, knowledge, and intent to defraud as the elements of a Section 152 violation)).
122. *Burke v. Dowling,* 944 F. Supp. 1036, 1065 (E.D. N.Y. 1995).
123. *6 Am. Bankr. Inst. L. Rev. 317* (Winter 1998): 331.
124. Id. at 332.
125. Id. at 336 (*citing United States v. Turner,* 725 F.2d 1154, 1157 (8th Cir. 1984) (analyzing the district court's definition and stating that one "withholds knowledge" or "prevents disclosure or recognition")).
126. 205 F.3d 1117 (9th Cir. 1999).
127. Id. at 1120.
128. Id. at 1121.
129. Id.
130. Id. at 1120.
131. 725 F.2d 1154 (8th Cir. 1984).
132. Id. at 1156.
133. Id. at 1158–59.
134. 29 F.3d 908 (4th Cir. 1994).
135. Id. at 910.
136. Id.
137. *American Bankruptcy Institute Journal* (Spring 1997): 2.
138. 114 F.2d 558 (3rd Cir. 1940).
139. Id. at 560.
140. Id.
141. Id.
142. Id.

143. *United States v. Sabbeth,* 125 F. Supp. 2d 33, 37 (E.D. N.Y. 2000) (*citing United States v. Shapiro*, 101 F.2d 375, 379 (7th Cir. 1939)).
144. 125 F. Supp. 2d 33 (E.D. N.Y. 2000).
145. 18 U.S.C. § 152(2).
146. 18 U.S.C. § 152(3).
147. *6 Am. Bankr. Inst. L. Rev. 409* (Winter 1998): 425 (*citing Metheany v. United States,* 390 F.2d 559, 561 (9th Cir. 1968) (referring to the essential element of fraud charge in a bankruptcy proceeding)).
148. Id. (*citing United States v. Young,* 339 F.2d 1003, 1004 (7th Cir. 1964) (stating that the offense of making a false oath is completed at the time the false schedule is sworn to and filed, regardless of any subsequent disclosure)).
149. Id. at 425–26 (*citing United States v. Diorio,* 451 F.2d 21 (2nd Cir. 1971) (affirming conviction for failure to disclose corporate assets)).
150. *United States v. O'Donnell,* 539 F.2d 1233, 1237-38 (9th Cir. 1972).
151. 853 F.2d 568 (7th Cir. 1988).
152. Id. at 570.
153. Id.
154. Id. at 569.
155. Id. at 571.
156. Id.
157. Id. (*citing United States v. Overmeyer,* 867 F.2d 937, 949 (6th Cir. 1989)).
158. *United States v. Connery,* 867 F.2d 929, 934 (6th Cir. 1989).
159. *6 Am. Bankr. Inst. L. Rev. 409* (Winter 1998): 427.
160. Id. at 428.
161. 168 F. Supp. 728 (W.D. Pa. 1958).
162. Id. at 729.
163. Id. at 730.
164. 226 F. Supp. 312 (N.D. Ok. 1964).
165. Id. at 314.
166. Id.
167. 120 F.3d 856 (8th Cir. 1997).
168. Id. at 860.
169. Id.
170. Id.
171. Id. at 861.
172. Id.
173. Id.
174. Id.
175. Id.
176. Id.
177. Id.
178. Id. at 862.
179. Id.
180. Id. at 862–63.
181. 125 F.3d 1024 (7th Cir. 1997).
182. Id. at 1026.
183. Id.
184. Id. at 1026–27.

185. Id. at 1027.
186. Id.
187. Id.
188. Id.
189. Id. at 1028.
190. Id. at 1035.
191. *Jackson v. United States,* 72 F.2d 764 (3rd Cir. 1934).
192. 330 F. Supp. 2d 499 (E.D. Pa. 2004).
193. Id. at 504 (*citing United States v. Pollen,* 978 F.2d 78, 83 (3rd Cir. 1992)).
194. Id.
195. Id. at 504–05.
196. 18 U.S.C. § 157.
197. *6 Am. Bankr. Inst. L. Rev. 409* (Winter 1998): 431.
198. Id.
199. 18 U.S.C. § 157(1).
200. 18 U.S.C. § 157(2).
201. 18 U.S.C. § 157(3).
202. *See United States v. Daniels,* 247 F.3d 598 (5th Cir. 2001) (holding that filing of bankruptcy to prevent foreclosures on properties of shell corporation constituted bankruptcy fraud).
203. *United States v. McBride,* 362 F.3d 360, 373 (6th Cir. 2004) (*quoting United States v. DeSantis,* 237 F.3d 607, 613 (6th Cir. 2001)).
204. 4 Fed. Appx. 420 (9th Cir. 2001).
205. Id.
206. *6 Am. Bankr. Inst. L. Rev. 409* (Winter 1998): 421.
207. Id. at 423.
208. 18 U.S.C. § 154.
209. 18 U.S.C. § 155.
210. *In re Gianulias,* 111 B.R. 807, 870 (E.D. Cal. 1989).
211. 422 F.2d 200 (9th Cir. 1970).
212. Id. at 207.
213. Id.
214. 18 U.S.C. § 156.
215. Id.
216. 11 U.S.C. § 110(a)(1).
217. *In re Merriam,* 250 B.R. 724 (Bankr. D. Co. 2000).
218. The only case citing this statute is an unreported decision in *Thrower v. U.S.,* 2005 WL 1460128 (N.D. Ohio 2005).
219. Keith Palfin and Sandhya Prabhu, "Obstruction of Justice." *Am. Crim. L. Rev. 873* (2003): 874.
220. Jonathan D. Polkes, "Obstruction of Justice Nexus Requirement Unclear in New Statutes." *N.Y. L.J.* (July 7, 2003): 7 (criticizing the language as "undefined and unspecific" and alluding to notice problems that would accompany a vagueness criticism).
221. Maryland, New York, Wyoming, and the U.S. Territory of the Virgin Islands continue to retain the UFCA, while all others states have adopted the UFTA. *See* Appendix 17A for a listing of statutory references by state.
222. The two-year lookback applies to cases filed one year *after* the effectiveness of the Bankruptcy Abuse Act. The period is one year for all other cases. 11 U.S.C. § 548.
223. Peter M.Alces and Luther M. Dorr, "A Critical Analysis of the New Uniform Fraudulent Transfer Act." *U. Ill. L. Rev. 527* (1985): 530. Collier on Bankruptcy ¶ 548.01[2] (15th Edition Rev. 2006).

224. 13 Eliz., ch. 5 (1570) (Eng.) (providing text of statute).
225. *See Breitenstine v. Breitenstine,* 62 P.3d 587, 592 (Wyo. 2003).
226. *Twyne's Case,* 76 Eng. Rep. 809 (Star Chamber 1601).
227. *Breitenstine,* 62 P.3d at 593 (listing some of the more common badges of fraud).
228. *Twyne's Case,* 76 Eng. Rep. at 812–14.
229. *See* Appendix 17B for full text of Uniform Fraudulent Conveyance Act.
230. *In re Reed's Estate,* 566 P.2d 587 (Wyo. 1977).
231. Id. at 590–91.
232. *In re Otis & Edwards, P.C.,* 115 B.R. 900, 913 (Bankr. E.D. Mich. 1990).
233. UFCA § 4.
234. UFCA § 5.
235. UFCA § 6.
236. UFCA § 3.
237. *Halsey v. Winant,* 258 N.Y. 512, 513 (N.Y. 1932).
238. Id.; *see also Matter of Oppenheim,* 269 App. Div. 1040 (N.Y. 1945).
239. *See* Appendix 17C for full text of the Uniform Fraudulent Transfer Act.
240. UFCA § 4(a)(1).
241. UFTA § 4(b).
242. UFTA § 4, comment 5.
243. UFTA § 4, comment 6.
244. Alces and Dorr, *U. Ill. L. Rev. 527* (1985).
245. Id.
246. *Compare* UFCA §§ 4-6 (requiring proof of less than "fair consideration") *with* UFTA §§ 4(a)(2) and 5 (requiring proof of less than "reasonably equivalent value").
247. UFTA § 5(a).
248. UFTA § 4(a)(2)(i).
249. UFTA § 4(a)(2)(ii).
250. UFCA § 3. "Fair consideration is given for property, or obligation, (a) When in exchange for such property, or obligation, as a fair equivalent therefore, and in good faith, property is conveyed or an antecedent debt is satisfied . . . ." Id.
251. UFTA §§ 4(a)(2) and 5(a).
252. UFTA § 8(a).
253. Alces and Dorr, *U. Ill. L. Rev. 527* (1985). The UFTA provides a general, nonexclusive definition of "value," adopted from 11 U.S.C. § 548(d)(2). UFTA § 3, comment 2.
254. *Shape, Inc. v. Midwest Engineering (In re Shape, Inc.),* 176 B.R. 1 (Bankr. D. Me. 1994).
255. Id.
256. *BFP v. Resolution Trust Corporation,* 511 U.S. 531 (1994).
257. Alces and Dorr, *U. Ill. L. Rev. 527. See also* Collier on Bankruptcy ¶ 548.05[1][b] (15th Ed. Rev. 2006). *See Klein v. Tabatchnick,* 610 F.2d 1043 (2d Cir. 1979) (allowing consideration of the debtor's need for the challenged loan and the ability to obtain a loan elsewhere as well as the value of the securities transferred in exchange for the loan); *accord, Roth v. Fabrikant Bros.,* 175 F.2d 665 (2d Cir. 1949); *Security Discount Co. v. Wesner (In re Peoria Braumeister Co.),* 138 F.2d 520 (7th Cir. 1943); *Pennsylvania Trust Co. v. Schenecker,* 289 Pa. 277 (1927).
258. Alces and Dorr, *1985 U. Ill. L. Rev. 527. See also* Collier on Bankruptcy ¶ 548.05[1][b] (15th Ed. Rev. 2006).
259. UFCA § 7; UFTA § 4(C)(1).
260. UFCA § 4; UFTA § 5.
261. UFCA §§ 5 and 6; UFTA §§ 4(a)(2)(i) and (ii).

262. *See* Appendix 17E for full text of 11 U.S.C. § 548.
263. The two-year look-back applies to cases filed one year *after* the effectiveness of the Bankruptcy Amendments. The period is one year for all other cases. 11 U.S.C. § 548.
264. 11 U.S.C. § 548(a)(1). Like the UFTA, the Bankruptcy Code applies the "reasonably equivalent value" standard rather than the "fair consideration" standard used by the UFCA, thereby shifting the inquiry from the debtor's thoughts at the time of the transfer to the impact of the transfer upon the creditors.
265. 11 U.S.C. § 548(a)(2).
266. Collier on Bankruptcy, ¶ 548.01[4] (15th Ed. Rev. 2006).
267. 11 U.S.C. § 544.
268. White House Press Release (April 20, 2005).
269. *See* Appendix 17G for 11 U.S.C. § 101(31) of the Bankruptcy Code (providing a definition of an "insider").
270. *In re Lemanski*, 56 B.R. 981 (Bankr. W.D. Wis. 1986).
271. *In re Colesville Medical Center Ltd. Partnership*, 20 B.R. 87 (Bankr. D. Md. 1982); *See also In re Missionary Baptist Foundation, Inc.*, 712 F.2d 206 (5th Cir. 1983); *Butler v. David Shaw, Inc.*, 72 F.3d 437, 438 (4th Cir. 1996) (explaining that the definition of an insider is not exhaustive; rather, an insider may be any person or entity whose relations with debtor is sufficiently close so as to subject the relationship to close scrutiny; in order to satisfy this standard, the alleged insider must exercise sufficient authority over debtor so as to unqualifiedly dictate corporate policy on a disposition of corporate assets.); *Mishkin v. Siclari* (*In re Adler, Coleman Clearing Corp.*), 277 B.R. 520 (Bankr. S.D.N.Y 2002) (holding that an investor who held an account with a broker was found to be an insider, where the investor had close, personal relationship with the head trader at broker, the investor benefited from fraud and broker in ways that were not materially different from ways insider would, and investor's relations with the broker was not arm's length); and *In re Babcock Dairy Co.*, 70 B.R. 657 (Bankr. N.D. Ohio 1986) (finding that an allegation that a party that only had a superior bargaining position in contractual relationships with debtor was insufficient to qualify that party as an insider).
272. 11 U.S.C. § 548 (a)(1); UFCA § 7; and UFTA § 4(a)(1).
273. *Liquidation Trust of Hechinger Inv. Co. of Del., Inc. v. Fleet Retail Finance Group* (*In re Hechinger Investment Company of Delaware*), 327 B.R. 537, 550-51 (D. Del. 2005); *In re Victor Int'l, Inc.*, 97 Fed. Appx. 365, 369 (3d Cir. 2004); *Moody v. Sec. Pacific Bus. Credit, Inc.*, 971 F.2d 1056, 1064 (3d Cir. 1992), *affirming Moody v. Sec. Pacific Bus. Credit, Inc.*, 127 B.R. 958, 991 (Bankr. W.D. Pa. 1991).
274. *Moody*, 127 B.R. at 991; *In re Otis & Edwards, P.C.*, 115 B.R. 900, 913 (Bankr. E.D. Mich. 1990).
275. UFTA § 4(b).
276. 260 B.R. 88 (Bankr. E.D. Va. 2000), *aff'd* 43 Fed. Appx. 562 (4th Cir. 2002).
277. Id. at 111.
278. Id. at 116.
279. Id.
280. Id. at 113.
281. Id. at 114.
282. Id.
283. 257 F.3d 401 (4th Cir. 2001).
284. Id. *See also Hyman v. Porter* (*In re Porter*), 37 B.R. 56, 60–61 (Bankr E.D. Va. 1984); *Pauy v. Chastant* (*In re Chastant*), 873 F.2d 89, 91 (5th Cir. 1989).
285. Since the personal injury settlement proceeds would have been exempt under Virginia law, the court initially addressed the issue of whether transfers of property that would have been exempt from the bankruptcy estate under state law can be the subject of an avoidance and recovery action by the bankruptcy trustee on the ground that the debtor transferred the property with the intent to hinder,

delay, or defraud his creditors. Id. at 406. The court explained that "[in]disputably, had Smoot left the proceeds from the settlement of his FELA suit against CSX in his account, he could have exempted those proceeds from his bankruptcy estate." Id. After noting the split of authority on the issue, the court concluded that the majority position, "that transfers of exemptible property are amenable to avoidance and recovery actions by bankruptcy trustees," was better reasoned. Id. at 406–07. Therefore, the court held that Smoot's transfer of his personal injury settlement proceeds was subject to attack by his bankruptcy trustee. Id.

286. Id. at 408. *See also Hyman,* 37 B.R. at 60–61; and *Chastant,* 873 F.2d at 91.
287. *Smoot,* 257 F.3d at 408. *See also Porter*, 37 B.R. at 61.
288. *Smoot,* 257 F.3d at 408. The court also held that, in addition to avoiding the transfer on the basis of actual fraud under 11 U.S.C. § 548(a)(1)(A), the trustee was entitled to avoid the transfer under 11 U.S.C. § 548(a)(1)(B) because Smoot transferred the settlement proceeds without receiving any consideration and while he was insolvent. Id. at 409.
289. UFCA §§ 4, 5, and 6; UFTA §§ 4(a)(2) and 5; and 11 U.S.C. § 548(a).
290. *See In re Jeffrey Bigelow Design Group,* 956 F.2d 479 (4th Cir. 1992).
291. UFCA § 3(a).
292. *Sharp International Corporation v. State Street Bank and Trust Company* (*In re Sharp International Corporation*). 403 F.3d 43, 53–54 (2nd Cir. 2004).
293. *Consove v. Cohen* (*In re Roco Corp.*), 701 F.2d 978, 982 (1st Cir. 1993) ("[T]he value to be considered is that received by the [transferor] and not that forfeited by the transferee."); *SPC Plastics Corp. v. Griffith* (*In re Structurlite Plastics Corp.*), 193 B.R. 451, 456 (Bankr. S.D. Ohio 1995) ("[W]hether consideration in a transfer alleged to be fraudulent is 'fair' must be viewed from the standpoint of the [transferor]."). Neither the Bankruptcy Code nor the UFTA defines "reasonably equivalent value."
294. 511 U.S. 531 (1994).
295. Id.
296. *In re Morris Communications NC, Inc.,* 914 F.2d 458, 466 (4th Cir. 1990).
297. Among others, these courts have struggled to develop a workable test for reasonably equivalent value: *In re Young,* 82 F.3d 1407 (8th Cir. 1996) (determining whether the debtors obtained value in exchange for charitable contributions to a church); *In re Chomakos,* 69 F.3d 769 (6th Cir. 1995) (examining whether the debtors obtained value in exchange for $7,710 in gambling losses); *Morris,* 914 F.2d at 458 (attempting to determine the value of shares in a corporation whose only asset was a license application pending before the FCC that had a 1 in 22 chance of approval); *In re Fairchild Aircraft Corp.*, 6 F.3d 1119, 1125–26 (5th Cir. 1993) (deciding whether the money the debtor spent in a failed attempt to keep a commuter airline afloat conferred value on the debtor).
298. 92 F.3d 139 (4th Cir. 1996).
299. Id.
300. Id.
301. Id. at 148.
302. Id. at 153.
303. Id. at 148.
304. Id. at 153–54.
305. UFCA § 2(1).
306. Id.
307. *In re Moody,* 971 F.2d 1056, 1067 (*quoting Angier v. Worrell,* 31 A.2d 87, 89 (Pa. 1943)).
308. *United States v. Gleneagles Inv. Co.,* 565 F. Supp. 556, 578 (M.D. Pa. 1983).
309. *Moody,* 971 F.2d at 1067. *See also In re Taxman Clothing Co.*, 905 F.2d 166, 169–70 (7th Cir. 1990).
310. Collier on Bankruptcy, ¶ 101.32[4] (15th Ed. Rev. 2006).
311. *Moody v. Security Pac. Business Credit, Inc.*, 971 F.2d 1056, 1067 (3d Cir. 1992) (following the majority rule of going concern assets valuation when a bankruptcy is not clearly imminent).

312. UFTA § 2(a); 11 U.S.C. § 101(32).
313. *In re Smoot,* 265 B.R. 128 (Bankr. E.D. Va. 1999).
314. *Nordberg v. Arab Banking Corp. (In re Chase & Sanborn Corp.),* 904 F.2d 588, 594 (11th Cir. 1990); *In re Xonics Photochemical, Inc.,* 841 F.2d 198, 200 (7th Cir. 1988); *Covey v. Commercial National Bank of Peoria,* 960 F.2d 657 (7th Cir. 1992) (holding that contingent liability should be determined by multiplying total debt guaranteed by the probability that the debtor would be required to make good on a guarantee).
315. UFTA § 2(d); 11 U.S.C. § 32(A)(i).
316. UFTA § 2(b).
317. 960 F.2d 657 (7th Cir. 1992).
318. Id.
319. Id.
320. 227 B.R. 383 (Bankr. E.D. Pa. 1998).
321. Id.
322. Prior to commencing the action, the official committee of former partners of the debtor law firm obtained court authority to commence the action on behalf of the debtor's estate. Id. at 385.
323. Id. at 389.
324. Id.
325. *See* 11 U.S.C. 548(a)(1)(B)(ii); UFCA § 5; UFTA § 4(a)(2)(i).
326. *Steph v. Branch,* 255 F. Supp. 526 (E.D. Okla. 1966); *In re Atlas Foundry Co.,* 155 F. Supp. 615 (D. N.J. 1957) (describing how a purchaser of a business gave a mortgage on realty to the selling shareholders and used most of the company's cash to pay the selling shareholders for their shares, resulting in the corporation having an unreasonably small amount of capital to carry on its business, resulting in the mortgage being void as against the trustee).
327. *Matter of Atkinson,* 63 B.R. 266, 269 (Bankr. W.D. Wisc. 1986) (holding that for a violation of Section 5 of the UFCA, capital must be unreasonably small "relative to the nature of the venture").
328. 882 F.2d 1 (1st Cir. 1989).
329. Id. at 2.
330. Id.
331. Id. at 3.
332. Id.
333. Id.
334. Id. at 5.
335. Id. (*quoting Wells Fargo Bank v. Desert View Building Supplies,* 475 F. Supp. 693, 696 (D. Nev. 1978)).
336. Id.
337. *Harnett v. Doyle,* 16 Tenn. App. 302 (1932).
338. Id.
339. 242 F. Supp. 400 (W.D. N.C. 1965).
340. Id. at 401.
341. Id.
342. Id. In light of the court's decision in *Farmers Federal Cooperative,* lenders should use caution when making secured loans to financially distressed borrowers.
343. *Official Committee of Unsecured Creditors of Hechinger Investment Company of Delaware Inc. v. Fleet Retail Finance Group (In re Hechinger Investment Company),* 274 B.R. 71 (D. Del. 2002).
344. *Kupetz v. Wolf,* 845 F.2d 842 (9th Cir. 1988) (expressing doubt that "above board" LBOs are voidable as fraudulent conveyances). *See also Credit Managers Assoc. of Cal. v. The Federal Co.,* 629 F. Supp. 175, 179 (C.D. Cal. 1985) (stating that a court might hold that LBOs are exempt from fraudulent conveyance law).

345. 845 F.2d 842 (9th Cir. 1988).
346. Id.
347. Baird, Douglas G., and Jackson, Thomas H. "Fraudulent Conveyance Law and Its Proper Domain." *38 Vand. L. Rev. 829* (1985) (arguing that because fraudulent conveyance laws arose out of a simplistic and outdated sixteenth-century setting, applying such laws to transactions as modern and complex as an LBO is inappropriate).
348. Id. at 852.
349. *See, e.g. Lippi v. City Bank,* 955 F.2d 599 (9th Cir. 1992); *Mellon Bank v. Metro Communications,* 945 F.2d 635, 645–46 (3d Cir. 1991); *Kupetz v. Wolf,* 845 F.2d 842, 847 (9th Cir. 1988); *Aluminum Mills Corp. v. Citicorp (In re Aluminum Mills*), 132 B.R. 869, 885 (Bankr. N.D. Ill. 1991); *Crowthers McCall Pattern, Inc. v. Lewis,* 129 B.R. 992, 997–98 (S.D.N.Y. 1991); *Moody,* 127 B.R. at 989, n. 7; *Murphy,* 126 B.R. at 392; *Ferrari v. Barclay's Business Credit (In re Morse Tool*), 108 B.R. 389, 391 (Bankr. D. Mass. 1989); *Vadnais Lumber Supply v. Byrne (In re Vadnais Lumber Supply*), 100 B.R. 127, 134–35 (Bankr. D. Mass. 1989); *Wieboldt Stores v. Schottenstein,* 94 B.R. 488, 499 (N.D. Ill. 1988); *Ohio Corrugating Co. v. DPAC, Inc. (In re The Ohio Corrugating Co.*) (Ohio Corrugating II), 91 B.R. 430, 434–35 (Bankr. N.D. Ohio 1988); *Kaiser Steel v. Jacobs (In re Kaiser Steel*), 87 B.R. 154, 160–61 (Bankr. D. Colo. 1988); *Credit Managers Ass'n of Southern Cal. v. Federal Co.,* 629 F. Supp. 175, 179 (C.D. Cal. 1985); *Anderson Indus. v. Anderson (In re Anderson Indus.*), 55 B.R. 922, 926 (Bankr. W.D. Mich. 1985).
350. 565 F. Supp. 556 (M.D. Pa. 1983).
351. Id.
352. *United States v. Tabor Court Realty Corp.,* 803 F.2d 1288, 1297 (3rd Cir. 1986).
353. Id.
354. *See, e.g., Vadnais Lumber Supply v. Byrne (In re Vadnais Lumber Supply*), 100 B.R. 127 (Bankr. D. Mass 1989).
355. 327 B.R. 537 (D. Del. 2005).
356. Id.
357. A "triangular merger" is a method of amalgamation of two corporations by which the disappearing corporation is merged into a subsidiary of the acquiring corporation, and the shareholders of the disappearing corporation receive shares of the surviving corporation. *Black's Law Dictionary,* Abridged Sixth Edition.
358. *Hechinger,* 327 B.R. at 546.
359. Id. at 546–47.
360. Id. at 550–52.
361. Id. at 552.
362. Id.
363. Id.
364. Id.
365. Id.
366. Id.
367. Id.
368. Id.
369. Id. at 553.
370. Id.
371. Id.
372. Id.
373. Id.
374. Id.
375. Id.

376. *Hall v. Arthur Young & Co. (In re Computer Universe, Inc.)*, 58 B.R. 28 (Bankr. M.D. Fla. 1986).
377. *See, e.g., Garrett v. Faulkner (In re Royal Crown Bottlers of N. Ala., Inc.)*, 23 B.R. 28, 30 (Bankr. N.D. Ala. 1982); *Lawrence Paperboard Corp. v. Arlington Trust Co. (In re Lawrence Paperboard Corp.)*, 76 B.R. 866, 874 (Bankr. D. Mass. 1987).
378. *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981).
379. *Tryit Enterprises v. General Electric Capital Corp. (In re Tryit Enterprises)*, 121 B.R. 217 (Bankr. S.D. Tex. 1990).
380. Id.
381. Id. at 223.
382. Id. at 224.
383. Id.
384. Id. at 223.
385. *Martino v. Edison Worldwide Capital (In re Randy)*, 189 B.R. 425, 437, n. 17 (Bankr. N.D. Ill. 1995).
386. *In re Bennett Funding Group, Inc.*, Ch. 11, Case Nos. 96-61376, 96-61377, 96-61378, 96-61379, jointly administered.
387. Mark A. McDermott, "Ponzi Schemes and the Law of Fraudulent and Preferential Transfers." *72 Am. Bankr. L.J. 157* (Spring 1998).
388. *See Sender v. Johnson (In re Hedged-Invs. Assocs., Inc.)*, 84 F.3d 1267 (10th Cir. 1996) (stock options; approximately 1,400 investors ultimately lost $ 200 million in the scheme): *Jobin v. Youth Benefits Unlimited, Inc. (In re M&L Bus. Mach. Co.)*, 59 F.3d 1078 (10th Cir. 1995) (computer leasing companies); *Wyle v. C.H. Rider & Family (In re United Energy Corp.)*, 944 F.2d 589 (9th Cir. 1991) (energy modules); *Hayes v. Palm Seedlings Partners (In re Agricultural Research and Tech. Group)*, 916 F.2d 528 (9th Cir. 1990) (seed-germination facilities); *Apostolou v. Fisher,* 188 B.R. 958 (N.D. Ill. 1995) (commodities); *Brandt v. American Nat'l Bank & Trust Co. (In re Foos)*, 188 B.R. 239 (Bankr. N.D. Ill. 1995) (radio stations); *In re Lake States Commodities, Inc.*, 253 B.R. 866 (Bankr. N.D. Ill. 2000) (commodity futures trading and participation in commodity pools); *In re Carrozzella & Richardson,* 286 B.R. 480 (D. Conn. 2002) (deposit funds for fraudulent annual rate of return between 8 to15 percent); *In re Financial Federated Title & Trust, Inc.*, 309 F.3d 1325 (11th Cir. 2002) (life insurance policies); *U.S. v. Grasso,* 173 F. Supp. 2d 353 (E.D. Pa. 2001) (work-at-home scheme); *Bald Eagle Area School Dist. v. Keystone Financial, Inc.*, 189 F.3d 321 (3rd Cir. 1999) (investment in school bonds for construction); *S.E.C. v. SG Ltd.*, 265 F.3d 42 (1st Cir. 2001) (investment game for personal entertainment and Internet users); *U.S. v. Deavours,* 219 F.3d 400 (5th Cir. 2000) (wire transfers); *Chosnek v. Rolley.* 688 N.E.2d 202 (Ind. App. 1997) (fraudulent investment scheme); *In re Unified Commercial Capital, Inc.*, 260 B.R. 343 (Bankr. W.D. N.Y. 2001) (debentures and certificates of deposits); *In re Ramirez Rodriguez,* 209 B.R. 424 (Bankr. S.D. Tex. 1997) (equipment service procurement contracts); *U.S. v. Benson,* 79 Fed. Appx. 813 (6th Cir. 2003) (gasoline marketing scheme); *U.S. v. Gold Unlimited, Inc.*, 177 F.3d 472 (6th Cir. 1999) (cosmetic anti-saturation policies).
389. McDermott, *72 Am. Bankr. L.J. 157.*
390. *Jobin v. Lalan (In re M&L Business Machine Co.)*, 160 B.R. 851, 857 (Bankr. D. Colo. 1993), aff'd, 167 B.R. 219 (D. Colo. 1994). *See also In re Taubman,* 160 B.R. 964, 982 (Bankr. S.D. Ohio 1993) (holding that funds obtained from Ponzi scheme investors are property of the debtor's estate); and *Dicello v. Jenkins (In re International Loan Network, Inc.)*, 160 B.R. 1, 11 (Bankr. D. D.C. 1993) (noting the unanimous position of the courts that the debtor has an interest in property transferred through a Ponzi scheme).
391. *Jobin,* 160 B.R. at 857 (stating that "a claimant must be able to identify and trace the fraudulently deprived funds or property to which he claims ownership"); *Danning v. Bozek (In re Bullion Reserve of North America)*, 836 F.2d 1214, 1217 (9th Cir. 1988).
392. *Merrill v. Abbott (In re Independent Clearing House Co.)*, 77 B.R. 843, 857 (D. Utah 1987) (concluding that "the debtors received a 'reasonably equivalent value' in exchange for all transfers to a defendant that did not exceed the defendant's principal undertaking").

393. *Sender v. Buchanan (In re Hedged-Invs. Assocs., Inc.)*, 84 F.3d 1286, 1290 (10th Cir. 1996) (holding that a Ponzi debtor does not receive reasonably equivalent value in exchange for any amounts it transfers to an investor in excess of the investor's principal investment); *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995) (holding that, under the Illinois version of the UFCA, a debtor does not receive fair consideration for transfers of fictitious profits paid pursuant to a Ponzi scheme); *Scholes v. Ames*, 850 F. Supp. 707, 715 (N.D. Ill. 1994) (holding that payments received in good faith by investors in a fraudulent investment scheme in excess of the principal invested were "voluntary gifts" and hence fraudulent conveyances that could be recovered by receiver), *aff'd sub nom.*, 56 F.3d 750 (7th Cir. 1995).
394. 11 U.S.C. § 550(a).
395. Collier on Bankruptcy ¶ 550.02[4][a] (15th Ed. Rev. 2006).
396. *Southmark Corporation v. Schulte, Roth & Zabel, L.L.P.*, 242 B.R. 330 (5th Cir. 2000); *Security First National Bank v. Brunson (In re Coutee)*, 984 F.2d 138, 141 (5th Cir. 1993); *Liebersohn v. IRS (In re C.F. Foods, L.P.)*, 265 B.R. 71 (Bankr. E.D. Pa. 2001).
397. Collier on Bankruptcy ¶ 550.02[4][a] (15th Ed. Rev. 2006).
398. *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1200 (11th Cir. 1988).
399. *Southmark Corporation*, 242 B.R. at 338; *Danning v. Miller (In re Bullion Reserve of North America)*, 922 F.2d 544, 548 (9th Cir. 1991).
400. *Nordberg*, 848 F.2d at 1199.
401. Collier on Bankruptcy ¶ 550.02[4][b] (15th Ed. Rev. 2006) (*citing Nordberg*, 848 F.2d at 1196).
402. Collier on Bankruptcy ¶ 550.02[4][b] (15th Ed. Rev. 2006) (*citing Kupetz v. United States (In re California Trade Technical Schools, Inc.)*, 923 F.2d 641 (9th Cir. 1991)).
403. *In re Queen City Grain, Inc.*, 51 B.R. 722 (Bankr. S.D. Ohio 1985).
404. Collier on Bankruptcy ¶ 550.02[4][b] (15th Ed. Rev. 2006) (*citing Commercial Recovery, Inc. v. Mill Street, Inc. (In re Mill Street, Inc.)*, 96 B.R. 268 (9th Cir. B.A.P. 1989)).
405. Collier on Bankruptcy ¶ 550.02[4][b] (15th Ed. Rev. 2006) (*citing Lippi v. City Bank*, 955 F.2d 599 (9th Cir. 1992)).
406. 838 F.2d 890 (7th Cir. 1988).
407. Id. at 893.
408. Id.
409. *Gropper v. Unitrac, S.A. (In re Fabric Buys of Jerico, Inc.)*, 33 B.R. 334 (Bankr. S.D.N.Y. 1983).
410. *DuVoisin v. Kennerly, Montgomery, Howard & Finley (In re Southern Industrial Banking Corp.)*, 126 B.R. 294, 299 (E.D. Tenn. 1991). *See also Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196 (11th Cir. 1988); *Gropper v. Unitrac (In re Fabric Buys of Jericho, Inc.)*, 33 Bankr. 334 (Bankr. S.D. N.Y. 1983).
411. 11 U.S.C. § 550(b)(1).
412. Id.
413. H.R. Rep. No. 595, 95th Cong., 2d Sess. 376.
414. *Davis v. Cook Construction Co. (In re: SLF News Distribs., Inc.)*, 649 F.2d 613 (8th Cir. 1981).
415. 18 B.R. 778 (Bankr. W.D. Mo. 1982).
416. *See* Missouri's version of the Uniform Fraudulent Conveyance Act.
417. *Ohio Cellular Prods. Corp. v. Adams USA, Inc.*, 175 F.3d 1343, 1350 (Fed. Cir. 1999).
418. *Nizam's Institute of Medical Sciences v. Exchange Technologies, Inc.*, 1994 U.S. App LEXIS 16552, *11 (4th Cir. 1994) (*quoting Tedrow v. Deskin*, 290 A.2d 799, 802 (Md. 1972)).
419. Id.
420. Id.
421. *Teamsters Health and Welfare Fund of Philadelphia v. World Transportation, Inc.*, 241 F. Supp. 2d 499, 503 (E.D. Pa. 2003).

422. Id. (*quoting Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1522 (3rd Cir. 1994)).
423. 739 F.Supp. 231 (E.D. Pa. 1990).
424. Id. at 237.
425. *In re Healthco Int'l, Inc.*, 208 B.R. 288 (Bankr. D. Mass 1997).
426. 11 U.S.C. § 101(32).
427. Christopher W. Frost, "The Theory, Reality and Pragmatism of Corporate Governance in Bankruptcy Reorganizations." *72 Am. Bankr. L.J. 103* (1998): 107.
428. Id.
429. *In re Ben Franklin Retail Stores, Inc.*, 225 B.R. 646, 653 (Bankr. N.D. Ill. 1998) (*citing Geyer v. Ingersall Publications Co.*, 621 A.2d 784, 787 (Del. Ch. 1992)).
430. *Clarkson Co. Ltd. v. Shaheen*, 660 F.2d 506 (2nd Cir. 1991).
431. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1996 Del. Ch. LEXIS 157 (1996).
432. 242 B.R. 492 (B.A.P. 9th Cir. 1999).
433. Id. at 495.
434. 2005 U.S. Dist. LEXIS 23498 (N.D. Ill. 2005).
435. Id.
436. Id. at *4–5.
437. 229 F.3d 617, 623 (7th Cir. 2000).
438. *Coleman*, 2005 U.S. Dist. LEXIS at *4–5.
439. 344 Ill. App. 3d 15 (Ill. App. Ct. 2003).
440. *Coleman*, 2005 U.S. Dist. LEXIS at *5–6.
441. 377 F. Supp. 2d. 390, 412-14 (S.D.N.Y. 2005).
442. *Coleman*, 2005 U.S. Dist. LEXIS at *6–8.
443. Id. at *17.
444. Id. at *7.
445. 865 So. 2d 1272 (Fla. 2004).
446. Id.
447. Id. at 1273–74.
448. Id. at 1274.
449. Id.
450. Id. at 1275.
451. Id.
452. Id. at 1277.

(Family Transfer)

Scenario: **Debtor parent sells family vacation cottage to daughter. Price is fair.**

What if (1): Daughter puts nothing down. Finances entire purchase with a Note and Mortgage. 30 year term. 4% interest.

What if (2): Note contains a provision that forgives the balance upon the parents death

What if (3): Parent never records mortgage and daughter later incurs tax and judgment liens.

What if (4): Does it make a difference if the failure to record was intentional on the part of the parent?

What if (5): How about if the daughter never knew about the failure to record?

What if (6): What if the price is 5% below another bona fide offer? Net to parent is the same as a sale with a broker

Scenario: Life estates are often involved in conveyances like this. These result in repeated questions on our section listserv.

What if (1): How do you value life estates?

What if (2): What issues or problems do they present for valuation experts.

(Divorce Pending)

<u>Scenario:</u> Husband feels guilty and assumes more than a fair amount of the debt while giving up more than a fair amount of the assets. Husband's income then decreases and he realizes that he cannot afford to service all this debt. He files bankruptcy within 2 years of the divorce.

What if (1): What if the property division is equal in value but different in character? For Example: Husband gets all exempt assets and IRA. Wife gets everything else.

What if (2): Couple files Chapter 7 case. Husband has a large non-dischargeable judgment. Post-bankruptcy this judgment creditor garnishes wages. Couple now has 2 children. They decide to divorce, with husband to pay child support. The result is that the creditor will no longer be able to garnish the wife because she is not the judgment debtor. Nor will the creditor be able to garnish the husband because of his child support obligation.

What if (3): What if the couple continue living together?

What if (4): What sort of expert testimony or opinion would help in establishing or challenging the "fairness" of the divorce division?

What if (5): What effect, if any, is there in having findings of fact by the family court?

(Joint Accounts)

<u>Scenario:</u> Debtor has a joint account with a child. All the money in the account is from deposits from the child. Debtor is on the account for convenience purposes only. Debtor needs to file bankruptcy and cannot exempt the monies in the account.

What if (1): Debtor goes to the bank and has her name removed from the account?

What if (2): Debtor tells daughter to close the account and take all of the money

What if (3): Debtor tells daughter of upcoming bankruptcy and daughter decides on her own to empty the account?

(Funding a Closely Held Business)

<u>Scenario:</u> Debtor has non-exempt assets. These are converted to cash through bona fide sales to related persons. The debtor uses the cash to create a closely held business

What if (1): Debtor uses additional cash to promote the new business via an extensive newspaper, radio and television campaign on the eve of Bankruptcy.

What if (2): The debtor contracted for and pre-paid non-refundable advertising retainers for a protected marketing campaign?

What if (3): Does it make a difference if debtor's new business is one in which he provide personal services as opposed to a product?

CURRENT AND EMERGING TOPICS IN BUSINESS FRAUDULENT TRANSFER LAW

Addendum

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Addendum to:
Current and Emerging Topics in
Business Fraudulent Transfer Law

XIII. Attorney Liability

A. Aiding and Abetting Fraudulent Transfer

1. *Magten Asset Management Corp. v. Paul Hastings Janofsky & Walker, LLP*
2007 U.S. Dist. LEXIS 2786 (D. Del. 2007)
Rejected claim for attorney liability for aiding and abetting a fraudulent transfer and conspiracy under Montana law – recognizing that a majority of courts have similarly held (citing holdings by 5th Cir., 1st Cir, 8th Cir. and courts interpreting New York, Indiana, Rhode Island and Florida law).

2. *Edgewater Growth Capital Partners LLC v. H.I.G. Capital, Inc.,*
2010 Del. Ch. LEXIS 42 (D. Del. 2010)
No aiding and abetting cause of action for fraudulent transfer under Delaware law against directors – citing *Trenwick American Litigation v. Ernst & Young, LLP*, 906 A. 2d 168 (Del. Ch. 2006), aff'd 931 A. 2d 438 (Del. 2007).

3. *Warne Investments Ltd v. Higgins,*
219 Ariz. 186 (App. 2008)
No aiding and abetting cause of action for fraudulent transfer under Arizona law – citing *Freeman v. First Union National Bank*, 865 So. 2d 1272 (Fla. 2004).

4. *Mann v. GTCR Golden Rauner, LLC,*
483 F. Supp. 884 (D. Ariz. 2007)
No cause of action for aiding and abetting fraudulent transfer under Arizona law when applied to equity funds and individuals in management positions.

5. *Wiand v. Scoop Real Estate, LP,*
938 F. Supp. 2d 1238 (M.D. Fla. 2013)
No aiding and abetting cause of action under Florida UFTA, citing *Freeman*.

6. *GATX Corp. v. Addington*,
879 F. Supp. 2d 633 (E.D. Ky. 2012)
Same for Kentucky law recognizing similar holdings in the 5th, 8th and 10th Circuits.

7. *Arena Development Group, LLC v. Naegele Communications, LLC*,
2008 U.S. Dist. LEXIS 35628 (D. Minn. 2008)
Aiding and abetting question to be certified to Minnesota Supreme Court. (No subsequent history discovered.)

8. *Paloian v. Greenfield (In re: Restaurant Development Group, Inc.),*
397 B.R. 891 (Bankr. E.D. Ill. 2008)
Illinois courts recognize cause of action for aiding and abetting fraudulent transfers

B. Attorney as Transferee

1. Retainers

Dowling v. Chicago Options Assoc., Inc.,
226 Ill. 2d 277 (2007)

- True retainer – retainer earned when paid
- Security retainer – remains property of client, but attorney has a security interest to secure fees
- Advance payment retainer – for future services. Ownership passes to attorney when paid
- Dowling recognizes the ability to pay advance payment retainer to fight creditors – absent abuse.

2. Funds Held In Trust Account

a. *Martinez v. Harwell (In re Harwell),*
628 F.3d 1312 (11th Cir. 2010), on remand, 2011 Bankr. LEXIS 3687 (Bankr. M.D. Fla., Sept. 30, 2011), on appeal after remand, 2012 U.S. Dist. LEXIS 117665 (M.D. Fla., Aug. 21, 2012)
In order to avoid being an initial transferee under 11 U.S.C. §550, transferee must not have control of assets and act in good faith. When attorney played major role in alleged fraudulent transfer and had knowledge the possible fraudulent transfer of funds received from debtor and subsequently transferred by him to

third parties, and even though he did not control funds, he was liable as fraudulent transferee. Objective test – knew or should have known.

b. *Bonded Financial Services, Inc. v. European American Bank,* 838 F.2d 890 (7th Cir. 1988)
If transferee did not have dominion of funds, he could not be initial transferee under 11 U.S.C. §550, regardless of good faith.