

KOLEY ■ JESSEN

A T T O R N E Y S

EIGHTH CIRCUIT JUDICIAL CONFERENCE

Fraudulent Transfers in Bankruptcy

Friday, August 8, 2014

Donald L. Swanson

Koley Jessen P.C., L.L.O.

Stalnaker v. DLC, Ltd.,
376 F.3d 819 (8th Cir. 2004)

- Debtor's owner/officer/director paid all unsecured claims on eve of fraudulent transfer trial in an unsuccessful effort to defeat Trustee's administrative claims.

Doeling v. Grueneich,
400 B.R. 688 (8th Cir. BAP 2009)

- \$119,000 of value fraudulently transferred by Debtor to parents for \$65,000 consideration. Held: parents could not get their \$65,000 back, because they did not qualify as a “good faith transferee” under § 548(c) or § 550(e).

Sullivan v. Welsh (In re Lumbar),
457 B.R. 748 (8th Cir. BAP 2011)

- A transfer of exempt property can qualify as an avoidable fraudulent transfer. An avoided transfer of an otherwise-exempt asset is not subject to the exemption, if the transfer was voluntary (§ 522(g)).

*PW Enterprises, Inc. v. North Dakota Racing Commission
(In Re Racing Services, Inc.), 540 F.3d 892 (8th Cir. 2008)*

- The Court discussed “derivative standing” for a creditor to pursue Chapter 5 avoidance claims when the DIP or Trustee is “unable or unwilling to do so” and established these elements for the creditor to prove:
 - Creditor petitioned DIP/Trustee to bring the claim
 - The claim is “colorable”—would survive a motion to dismiss
 - DIP/Trustee unjustifiably refused to bring the claim—a cost-benefit analysis considering (i) probabilities of success and recovery, (ii) proposed fee arrangement, (iii) anticipated delay and expense to bankruptcy estate
 - Creditor sought Bankruptcy Court permission to bring the claim

Williams v. Marlar,
267 F.3d 764 (8th Cir. 2000)

- The Court affirmed a summary judgment on insolvency issues based upon the presumption of insolvency that arises under the Uniform Fraudulent Transfer Act from evidence that Debtor was not paying debts as they became due.
 - No similar presumption under § 548
 - See clarification on this presumption in proposed UFTA Amendments

Blackwell v. Lurie (In re Popkin & Stern),
223 F.3d 764 (8th Cir. 2000)

- A renunciation of inheritance is not a fraudulent transfer under Missouri's Uniform Fraudulent Transfer Act (and § 544(b))
- A renunciation of inheritance might be a fraudulent transfer under § 548

United States v. Novak,
217 F.3d 566 (8th Cir. 2000)

- A fraudulent transfer in anticipation of bankruptcy can be a crime, punishable by fine, imprisonment of not more than five years, or both. 18 U.S.C. § 152(7).

Addison v. Seaver (In re Addison),
540 F.3d 805 (8th Cir. 2008)

- Converting non-exempt assets into exempt assets on the eve of bankruptcy can defeat the exemption and prevent discharge, *but only if* evidence of actual fraud exists that is “extrinsic to the mere facts of conversion of non-exempt assets into exempt.”

Addison v. Seaver (In re Addison) -- Continued

- Examples cited for “extrinsic” evidence of actual fraud:
 - *Hanson v. First Nat’l Bank*, 848 F.2d 866 (8th Cir. 1988), sold nonexempt property for fair market value and used proceeds to maximize limited exemptions—not fraudulent
 - *In re Sholdan*, 108 F.3d 886 (8th Cir. 1997) (*Sholdan I*), and 217 F.3d 1006 (8th Cir. 2000) (*Sholdan II*), fraud found from 90 year-old debtor in assisted living selling all assets and buying a house and claiming homestead exemption.
 - *Norwest Bank v. Tveten*, 848 F.2d 871 (8th Cir. 1988), fraud found from converting all non-exempt assets (approx. \$700,000 value) into exempt on bankruptcy eve—too much and too aggressive.

11 U.S.C. § 551

- § 551. Automatic preservation of avoided transfer

Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

Seaver v. New Buffalo Auto Sales, LLC
(In re Hecker),
459 B.R. 6 (8th Cir. BAP 2011)

- Lien avoidance remedies:
 - Avoided transfer is “automatically preserved” for the bankruptcy estate under § 551
 - The estate may recover the interest transferred or its value under § 550(a)
 - A transferee’s lack of “good faith” allows the estate to retain the transferee’s “improvement” defined in § 550(e)((2))

Kaler v. Overboe (In re Arzt),
252 B.R. 138 (8th Cir. BAP 2000).

- The preservation-for-the-estate provisions of § 551 are “clear and unambiguous.”

Avoiding Debts as Fraudulent Transfers

■ Under § 548

“The trustee may avoid . . . any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was . . . incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—”

Avoiding Debts as Fraudulent Transfers

- **Under § 544(b) & UFTA**

- “[T]he trustee may avoid . . . any obligation incurred by the debtor . . . voidable under applicable (state) law.” (§ 544(b)).
- “A transfer made or obligation incurred by a debtor is fraudulent . . . “ (*UFTA—e.g., Neb. Rev. Stat. § 36-705(a)*).

Remedies for Avoided Obligation

- When an obligation is avoided as a fraudulent transfer, the preservation provisions of § 551 generally do not apply. The avoidance of an obligation merely reduces the amount of debts against a bankruptcy estate, without preserving anything for the bankruptcy estate.

Remedies for Avoided Obligation

- What is the significance of this language in § 551: “Any transfer avoided under . . . section 506(d) of this title, is preserved for the benefit of the estate”?
- § 506(d) provides: “To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.”
- Under what set of circumstances would these two provisions (§ 551 & § 506(d)) operate to preserve something valuable for the bankruptcy estate?
 - How about an obligation avoided as fraudulent that is secured by an in-the-money lien?

Recent Supreme Court Opinion: *Executive Benefits Insurance Agency v. Arkison*

- On June 9, 2014, the Supreme Court issued this long-awaited ruling on Bankruptcy Court jurisdiction to clarify *Stern v. Marshall*
- Held: the process of “proposed findings of fact and conclusions of law” from the Bankruptcy Court to the District Court authorized by 28 U.S.C. § 157(c)(1) was proper in this fraudulent transfer case.
- Unresolved:
 - What is the universe of cases to which § 157(c)(1) applies?
 - What is the extent of jurisdiction obtained by “consent of all the parties” under 28 U.S.C. § 157(c
 -)(2)?
 - What qualifies as “consent” ?
 - What are “appropriate orders and judgments” entered by “consent of all the parties” under § 157(c)(2)?

Miscellaneous Matters

- Proposed 2014 Amendments to Uniform Fraudulent Transfer Act—to be called “Uniform Voidable Transactions Act.”
- Clarifies:
 - choice of law rules,
 - effect of insolvency presumption from not paying debts when due,
 - Verbiage: “voidable” instead of “fraudulent”; and “transactions” instead of “transfers”

Miscellaneous

- Mediation of Fraudulent Transfer Disputes