

# **FRAUDULENT TRANSFERS**

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## **I. Introduction**

A fraudulent transfer may be roughly defined as an infringement of a creditor's rights to realize upon the available assets of a debtor. It is fraudulent for a debtor to transfer its assets to a third party with intent--either actual or constructive--to obstruct creditors from reaching the assets to satisfy their claims. The classic example of a fraudulent conveyance is an attempt by a financially-embarrassed debtor to remove assets from the grasp of creditors by transferring the assets for no consideration into the safe hands of friends or relatives.

In determining whether or not a transfer is fraudulent, the basic question is whether the transaction was a bona fide transaction or whether it was a mere trick or contrivance for the purpose of defeating creditors.<sup>1</sup> The question is determined as of the time of the transaction, and changed conditions will not alter the original transaction or make fraudulent a transaction which was not fraudulent at the time it occurred.<sup>2</sup> A conveyance made by a grantor for the purpose of hindering, delaying, or defrauding his or her creditors is invalid as against the creditors injured thereby, even though he or she intends that all his or her debts shall finally be paid.<sup>3</sup> A Chapter 7 Trustee may pursue a debtor's fraudulent transfer under either Bankruptcy Code (the "Code") § 548 or Indiana's Uniform Fraudulent Transfer Act ("UFTA"), which is codified at Ind. Code. § 32-18-2-19.

## **II. Fraudulent Transfers Under the Bankruptcy Code**

Section 548 of the Code prevents a debtor from engaging in transactions which have the effect of placing assets beyond the reach of creditors, and provides procedures for Chapter 7

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<sup>1</sup> *U.S. v. Denlinger*, 982 F.2d 233 (7<sup>th</sup> Cir. 1992).

<sup>2</sup> *Stamper v. Stamper*, 83 N.E.2d 1484 (Ind. 1949).

<sup>3</sup> *Cook v. Ball*, 144 F.2d 423 (7<sup>th</sup> Cir. 1944).

Trustees to recover such property. As a general proposition, the purpose of the Code's fraudulent transfer provision, in conjunction with the provision governing the liability of recipients of avoidable transfers located in Code § 550, is to return the bankruptcy estate to the position that it would have been in had the fraudulent transfer not occurred.

Section 550 of the Code provides that a trustee may recover transferred property for the benefit of the estate, or the value of such property if the court orders, from the initial transferee or the entity for whose benefit the transfer was made, or any intermediate or mediate transferee of the initial transferee, unless certain exceptions apply. 11 U.S.C. § 550. Thus, the usual remedy for a fraudulent conveyance is to void the transfer and recover the property or its value from the transferee.

The policy underlying § 548 is to protect creditors against the depletion of a bankruptcy estate by granting the trustee the power to set aside fraudulent transfers of the debtor's interests in property taking place within two years before the bankruptcy petition was filed. The date of transfer, for fraudulent conveyance purposes, is the date on which the transfer would have become perfected against a subsequent bona fide purchaser under applicable state law. 11 U.S.C. § 548(d)(1). To constitute a fraudulent transfer under § 548(a)(1)(A) of the Code, the transfer must be made with "actual intent to hinder, delay, or defraud a creditor." The focus is on the actual intent of the transferor, not the adequacy of consideration or the solvency of the transferor. Actual intent to defraud need not be shown by direct evidence, but may be inferred from the circumstances, or from certain indicia called "badges of fraud," in a transaction that

transfers an asset out of the reach of a creditor.<sup>4</sup>

As no single indicium constitutes a showing of fraudulent intent *per se*, the facts must be taken together to determine how many badges of fraud exist and if together they amount to a pattern of fraudulent intent.<sup>5</sup> Thus, where there is a concurrence of several badges of fraud, an inference of fraudulent intent in transferring property may be warranted.<sup>6</sup> A badge of fraud is present when the particular transfers greatly reduce a debtor's estate when a suit is pending or expected, and evidence of a hurried series of contemporaneous transfers also indicates fraud.<sup>7</sup> Furthermore, retention by a transferor of possession or interest in land conveyed is a badge of fraud, as is a transfer without consideration, or a transfer to close family members.<sup>8</sup> However, while inadequate consideration can be a badge of fraud, it does not require a finding of fraudulent intent.<sup>9</sup>

Initially, the primary purpose of fraudulent conveyance law was to prevent a debtor from *deliberately* taking action to hinder, delay, or defraud his or her creditors. As fraudulent conveyance law evolved, it was extended to cases in which even though the subjective intent of the debtor was not to defraud, the objective result of the transfer worked to the detriment of his or her creditors. Transfers that did not pass the objective test were eventually referred to as

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<sup>4</sup> *Indianapolis Indiana Aamco Dealers Advertising Pool v. Anderson*, 746 N.E.2d 383 (Ind. Ct. App. 2001).

<sup>5</sup> *Greenfield v. Arden Seven Penn Partners, L.P.*, 757 N.E.2d 699 (Ind. Ct. App. 2001).

<sup>6</sup> *Lee's Ready Mix and Trucking, Inc. v. Creech*, 660 N.E.2d 1033 (Ind. Ct. App 1996).

<sup>7</sup> *Greenfield v. Arden Seven Penn Partners, L.P.*, 757 N.E.2d 699 (Ind. Ct. App. 2001).

<sup>8</sup> *Jackson v. Farmers State Bank*, 481 N.E.2d 395 (Ind. Ct. App 1<sup>st</sup> Dist. 1985).

"constructively" fraudulent. Section 548 of the Code provides the bankruptcy trustee the ability and authority to avoid such fraudulent transfers. Thus, even though § 548(a) of the Code provides that the trustee cannot recover property as a fraudulent conveyance unless he or she can prove "actual intent" to hinder, delay, or defraud a creditor, section 548(a)(1)(B) allows the trustee to recover transfers under an "implied fraud" analysis, where transfers that were made under such suspicious circumstances are conclusively presumed to have been fraudulent without any proof of the debtor's subjective intent.<sup>10</sup>

Based on the different evidentiary tests set forth in § 548(a)(1)(A) and § 548(a)(1)(B), bankruptcy courts have held that implied fraud under § 548(a)(1)(B) is subject to the "preponderance of the evidence" standard and not the more difficult "clear and convincing" standard applied to prove actual fraud.<sup>11</sup> The good faith defense applies to both actual and constructive fraud claims, and allows the transferee to obtain a lien or retain any interest transferred or enforce any obligation incurred to the extent of the value given. 11 U.S.C. § 548(c). However, the Code does not define good faith.

A transfer may also be deemed to be constructively fraudulent under § 548(a)(1)(B) of the Code, and may be avoided by the trustee if, within two years prior to the filing of the bankruptcy petition, the creditor receives "less than reasonably equivalent value" in a transaction and the transaction meets anyone of the following requirements: (1) the transferor was insolvent

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<sup>9</sup> *U.S. Marketing Concepts, Inc. v. Don Jacobs Buick-Subaru, Inc.*, 547 N.E.2d 892 (Ind. Ct. App. 3d Dist. 1989).

<sup>10</sup> *In re Jackson*, 318 B.R. 5 (Bankr. D.N.H. 2004) (finding that actual intent of debtor is "irrelevant" with respect to determination of constructive fraud under the UFTA).

<sup>11</sup> *See id.* at 13.

at the time of the transfer or was rendered insolvent as the result of the transfer; (2) the transferor was undercapitalized at the time of the transfer or became undercapitalized as the result of the transfer; or (3) the transferor was unable or rendered unable by the transfer to pay its debts as they became due. 11 U.S.C. § 548(a)(1)(B)(ii)(I)-(III). Upon avoidance of the transfer, the property would then be transferred back to the estate, subject to a lien for whatever price was paid for the asset. 11 U.S.C. § 548(a)(1)(B).

### **III. Tolling of Statutes of Limitations Under Code Section 108(c)**

Recognizing that a petition in bankruptcy could sometimes give a debtor unfair advantage over a claimant by allowing the debtor to remain under the protection of the automatic stay until the limitation period governing the claims expired, Congress enacted Code § 108(c). In doing so, Congress "acted to solidly preserve the rights of a party stayed from commencing or continuing an action against the debtor because of the bankruptcy case".<sup>12</sup> The explicit language of Code § 108(c) provides that where the statute of limitations at issue has not expired before the date of the filing of a bankruptcy petition, the statute of limitations will not expire until the later of (1) the end of the time period; or (2) thirty days after notice of the termination or expiration of the automatic stay.

Several courts have issued opinions involving the variety of issues that arise under Code § 108(c). In *ECC Construction, Inc. v. Oak Park Calabasas Homeowners' Association*, 19 Cal. Rptr. 3d 340 (Cal. Ct. App. 2004), the court found that filing a notice of appeal does not constitute the commencement or continuation of a judicial proceeding within the meaning of § 362(a)(1), and the filing of a bankruptcy petition and imposition of the automatic stay did not toll

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<sup>12</sup> *In re Morton*, 966 F.2d 561, 566 (2d Cir. 1989).

the running of the period of time in which defendant was required to file its notice of appeal. Furthermore, the court rejected the argument that the deadline to appeal is extended by either Code §§ 108(a) or 108(b), and concluded that the only extension created by that section is the 30-day period provided for by Code § 108(c)(2).

In *In re Morton*, 866 F.2d 561, 566 (2d Cir.1989), the court held that Code § 108(c) "tolls New York's ten-year period limiting judgment liens on real property until the automatic stay is terminated . . . and because the limitation period governing that lien had not yet expired, the running of the period is tolled pursuant to § 108(c)(1)-(2)."<sup>13</sup> The *Morton* court went on to say that, even where there is no motion to extend, the lien is extended by operation of Code section 108(c) and under this provision, the docketing lien cannot die during a bankruptcy proceeding, because there is always thirty days of lien life after the automatic stay is finally terminated. "To now hold that New York's period limiting the validity of the lien and the bank's right to priority continued to run while federal bankruptcy law prohibited the bank from executing on its judgment not only would create a substantial inequity, but also would give the debtor the power to eliminate certain secured claims simply by filing for bankruptcy at the appropriate time and then allowing the limitation period to run while it remained under the protection of the automatic stay. This is the exact type of inequity Congress sought to remedy by enacting § 108(c).

In the case *In re Bernstein*, 259 B.R. 555 (Bankr. D.N.J. 2001), the court held that even though New Jersey's Uniform Fraudulent Transfer Act ("UFTA") four-year statute of limitations had expired prior to the date of the petition, the trustee could prosecute an action for a fraudulent conveyance under Code § 544(b) because he may have been able to prove that the unsecured

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<sup>13</sup> *Id.*

creditor could have availed himself of the UFTA's one-year tolling provision.<sup>14</sup> However the court also made it clear that: "there is no cause of action under Code section 544(b), and hence no extension under Code section 546(a) of the time to sue, if the creditor in whose place the trustee stands under Code section 544(b) had no right to sue on the petition date because the cause of action had expired by then, i.e., the Code does not resurrect a cause of action which did not exist as of the petition date."<sup>15</sup>

In *SASCO v. Zudkewich*, 767 A.2d 469 (N.J. 2001), the New Jersey Supreme Court analyzed New Jersey's statutory one-year tolling provision and determined that the critical issue as to the one-year tolling provision is "when an objectively reasonable claimant would have discovered the transfer."<sup>16</sup> The court reasoned that "a reasonable creditor would perform an asset search when the loan goes into default."<sup>17</sup> Therefore, the creditor has one year from that point under the tolling provision to file an action under the state's UFTA.<sup>18</sup> For trustees this means that as long as there is at least one unsecured creditor with a claim that arose within one year of the petition date, and that claim meets the criteria for the one-year tolling provision as articulated in *SASCO*, then the trustee's complaint is timely under Code section 546(a) and case law thereunder.

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<sup>14</sup> *In re Bernstein*, 259 B.R. 559-60 (Bankr. D.N.J. 2001).

<sup>15</sup> *Id.*

<sup>16</sup> *SASCO v. Zudkewich*, 767 A.2d 469, 474 (N.J. 2001).

<sup>17</sup> *Id.* at 476.

<sup>18</sup> *Id.* at 476-77.



In *Neal v. Keystone Steel and Wire*, 2007 WL 2680946 (C.D. Ill. 2007), the court noted that in *WorldCom*,<sup>19</sup> the creditor plaintiff argued that the plan's injunction extended the automatic stay and continued the statutory tolling of Code § 108(c).<sup>20</sup> This argument was legally precluded by the precise language of Code § 108(c); extending the automatic statutory tolling of §108(c) to include the time during the pendency of an injunction based on a section that was not enumerated in § 108(c) would be inappropriate.<sup>21</sup> However, the plaintiff in *Neal* was not asserting such an argument. Instead, the plaintiff argued that "the doctrine of equitable tolling should extend the statute of limitations on her Title VII claim because, while she did file more than 807 days after receiving the notice of right to sue, first the automatic stay, and then the Plan's injunction and the injunction of § 524, prohibited her from filing earlier."<sup>22</sup>

The court found that the plaintiff's argument was not precluded by the precise holding of the Southern District of New York in *WorldCom*. In fact, in *Montoya v. U.S.*, 965 F.2d 554 (7th Cir. 1992), the Seventh Circuit ruled that a nonbankruptcy statute of limitations may be tolled by proceedings in the bankruptcy other than as provided for in Code § 108 as a consequence of an automatic stay. In *Montoya*, the court found "[n]othing in § 108(c) . . . restricts any tolling of nonbankruptcy statutes of limitations to the time a creditor is barred from acting because of the provisions of the automatic stay. . . . [Section] 108(c) suspends nonbankruptcy statutes of limitations until the stay is lifted *or* the statute of limitations itself expires."<sup>23</sup>

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<sup>19</sup> *In re WorldCom, Inc.*, 362 B.R. 96 (Bankr. S.D.N.Y. 2007).

<sup>20</sup> *Id.* at 102.

<sup>21</sup> *Id.* at 110.

<sup>22</sup> *Neal* at 6.

<sup>23</sup> *Montoya v. U.S.*, 965 F.2d 554, 557 (7<sup>th</sup> Cir. 1992).

"While the Seventh Circuit did not reach the question of whether the terms of the plan might also serve to toll the Internal Revenue Service's statute of limitations, and therefore provide a decision even more on point," the Central District of Illinois' "reading of *Montoya* is that nothing forbids tolling above and beyond the extension provided for in Code §108 as a result of the automatic stay. Therefore, it is possible that other bankruptcy proceedings (aside from the automatic stay) may serve as an impediment to a claim such that further tolling of the statute of limitations, such as equitable tolling, may be appropriate."<sup>24</sup>

However, simply because the court in *Neal* "concluded that § 108(c) does not foreclose any further tolling of a nonbankruptcy statute of limitations, it does not automatically follow that equitable tolling is appropriate under the circumstances of this case."<sup>25</sup> "Equitable tolling of the 90-day period of limitation on the filing of an employment discrimination suit under Title VII is reserved for situations in which the claimant has either (1) made a good faith error (e.g., brought the suit in the wrong court); or (2) has been prevented from filing in an extraordinary way."<sup>26</sup> In general, "a person is not required to sue within the statutory period if he cannot in the circumstances reasonably be expected to do so."<sup>27</sup> However, "there must be diligence, and the diligence must continue up to the time of suit. . . ."<sup>28</sup>

The Court in *Neal* found there was that diligence: "[n]owhere in this chain of events has [the plaintiff] 'sat idly by' or failed to exercise diligence in attempting to secure adequate

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<sup>24</sup> *Neal, supra*, at 7.

<sup>25</sup> *Id.*

<sup>26</sup> *Threadgill v. Moore U.S.A., Inc.*, 269 F.3d 848, 850 (7<sup>th</sup> Cir. 2001).

<sup>27</sup> *Heck v. Humphrey*, 997 F.2d 355, 357 (7<sup>th</sup> Cir. 1993).

<sup>28</sup> *Id.*

treatment of her claim within the restrictions of the bankruptcy proceedings. All together, the repeated continuation of the objection to [the plaintiff's] claim, the operation of the automatic stay and then the injunction under the Plan and § 524, the parties' lengthy settlement negotiations, and the time devoted to the resolution of Keystone's motion to bar [the plaintiff's] claim, merit the application of equitable tolling.”<sup>29</sup>

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<sup>29</sup> *Neal* at 8.

## **APPENDIX**

### **11 U.S.C. § 108. Extension of time.**

(c) Except as provided in section 524 of this title, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor, or against an individual with respect to which such individual is protected under section 1201 or 1301 of this title, and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of--

- (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
- (2) 30 days after notice of the termination or expiration of the stay under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

### **11 U.S.C. § 544. Trustee as lien creditor and as successor to certain creditors and purchasers.**

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--

- (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
- (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or
- (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

(b)(1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

- (2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason

of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

**11 U.S.C. § 546. Limitations on avoiding powers.**

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of--

(1) the later of---

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

**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 . . .

**11 U.S.C. § 550. Liability of transferee of avoided transfer.**

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, 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.

(b) The trustee may not recover under section (a)(2) of this section from--

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) If a transfer made between 90 days and one year before the filing of the petition--

(1) is avoided under section 547(b) of this title; and

(2) was made for the benefit of a creditor that at the time of such transfer was an insider;

the trustee may not recover under subsection (a) from a transferee that is not an insider.

(d) The trustee is entitled to only a single satisfaction under subsection (a) of this section.

(e)(1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of--

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and

(B) any increase in the value of such property as a result of such improvement, of the property transferred.

(2) In this subsection, "improvement" includes—

(A) physical additions or changes to the property transferred;

(B) repairs to such property;

(C) payment of any tax on such property;

(D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee; and

(E) preservation of such property.

(f) An action or proceeding under this section may not be commenced after the earlier of—

(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or

(2) the time the case is closed or dismissed.