Antitrust law has long functioned on the basis of a "rule of reason,"[180] oil and gas law is premised in large measure on the "reasonably prudent operator" standard,[181] Anglo-American tort law routinely refers to the "reasonable and prudent man,"[182] property law allows easement owners to make reasonable use of a right of way,[183] and finally, Fourth Amendment law bars "unreasonable" searches and seizures.[184] Therefore, by imposing a reasonableness standard on transfers instead of a more exacting test, UFTA has opted for a widely accepted test of behavior.

A "rule of reason" approach is also justified on policy grounds, as there are difficulties associated with measuring debts, particularly future ones. For instance, quantifying the extent of present debt is often relatively simple. Although present creditors are not always known and the amounts of a claim may be indefinite or disputed, present creditors are easier to recognize, quantify, and accommodate than future creditors.[185] Future creditors are much more problematic because their

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[180]United States v. American Tobacco Co., 221 U.S. 106, 179 (1911) (upholding the notion that the Anti-trust Act of 1890 "must have a reasonable construction"); Standard Oil Co. v. United States, 221 U.S. 1, 60-65 (1911) (same); Seagood Trading Corp. v. Jerrico, Inc., 924 F.2d 1555, 1567-69 (11th Cir. 1991) (declaring that the rule of reason standard presumptively applies and that the per se rule "should be applied infrequently and with caution"); 3 HON. EDWARD J. DEVITT ET AL., FEDERAL JURY PRACTICE AND INSTRUCTIONS § 90.17 (4th ed. 1987) (pertaining to antitrust jury instructions).

[181]*E.g.*, Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 567-68 (Tex. 1981) ("The standard of care in testing the performance of implied covenants by [oil and gas] lessees is that of a reasonably prudent operator under the same or similar facts and circumstances.").

[182]*E.g.*, Freeman v. Adams, 218 P. 600, 603-04 (Cal. Ct. App. 1923); *accord* Di Cosala v. Kay, 450 A.2d 508, 517 (N.J. 1982) (referring to the "reasonably prudent and careful person"); Whitman v. W.T. Grant Co., 395 P.2d 918, 920 (Utah 1964) (applying the "universally accepted standard of care: that of the ordinary, reasonable and prudent man under the circumstances"); Hall v. Brooklands Auto Racing Club, 1 Eng. Rep. 205, 224 (K.B. 1933) (referring to "the man in the street").

[183]See, e.g., Williams v. Northern Natural Gas Co., 136 F. Supp. 514, 517 (N.D. Iowa 1955), in which the court noted, "It is generally stated that the grantee of an easement is entitled to do what is reasonably necessary for full and proper enjoyment of the rights granted him under the easement." *Accord* Swango Homes, Inc. v. Columbia Gas Transmission Corp., 806 F. Supp. 180, 185 (S.D. Ohio 1992) (holding that utility companies, under Ohio law, have a right to "remove obstructions which unreasonably or unlawfully interfere with the company's easement"); Hodgkins v. Bianchini, 80 N.E.2d 464, 467 (Mass. 1948) (discussing the right to use a "right of way").

[184]The Fourth Amendment states that the "right of the people to be secure in their persons, houses, papers, and effects, against unreasonable . . . seizures, shall not be violated." U.S. CONST. amend. IV. Hence, "'reasonableness is still the ultimate standard' under the Fourth Amendment." Soldal v. Cook County, Ill., 506 U.S. 56, 71 (1992) (quoting Camara v. Municipal Court of San Francisco, 387 U.S. 523, 539 (1967)).

[185]An example of an unknown present creditor would be a doctor who has unwittingly committed malpractice the day before making transfers may not know about his patient's claim

needs can be difficult to gauge. Today's transferor can only analyze the needs of future creditors by making an educated guess as to the identity of future claimants and the size and merits of their claims. However, since the ability to accurately forecast is inversely related to how far one gazes into the future, debtors cannot be asked to provide anything more than an objectively reasonable projection of their future circumstances. Since the law should not impose extraordinary burdens upon its citizens, policy considerations should prohibit asking transferors to predict beyond their reasonably foreseeable debts.[186]

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for months thereafter. The patient is still a present creditor because he holds a claim that arose at the moment of the tort. UFTA § 1(3)-(4), 7A U.L.A. at 644 (defining "creditor" and "claim" respectively); *id.* § 1, cmt. 4, 7A U.L.A. at 646-47; *see also* Stein v. Brown, 480 N.E.2d 1121, 1124 (Ohio 1985) (defining "creditor"). Furthermore, the amount of many claims, such as known malpractice claims, is often subject to dispute. UFTA realizes that such disputes are possible. In defining and discussing "insolvency," the UFTA Commissioners state, "A presumption of insolvency does not arise from nonpayment of a debt as to which there is a genuine bona fide dispute, even though the debt is a substantial part of the debtor's indebtedness." UFTA § 2, cmt. 2, 7A U.L.A. at 648-49.

[186]As an aside, it is highly likely that the Constitution limits UFTA to a rule of reason approach when projecting future finances. The right to use and enjoy property is a constitutionally protected right, and restraints upon an owner's right to use and enjoy property immediately raise constitutional concerns. Lynch v. Household Fin. Corp., 405 U.S. 538, 552 (1972). For example, courts "have frequently recognized that a radical curtailment of a landowner's freedom to make use of or ability to derive income from his land may give rise to a taking within the meaning of the Fifth Amendment, even if the Government has not physically intruded upon the premises or acquired a legal interest in the property." Kirby Forest Indus., Inc. v. United States, 467 U.S. 1, 14 (1984). Likewise, taking property from one class in order to benefit another class has also raised Fifth Amendment concerns. *See, e.g.*, Hawaii Housing Auth. v. Midkiff, 467 U.S. 229 (1984). Similarly, actions which deprive plaintiffs of liberty or property interests have triggered the Due Process clause of the Fourteenth Amendment. *See, e.g.*, Riverview Invs., Inc. v. Ottawa Community Improvement Corp., 769 F.2d 324, 327 (6th Cir. 1985) (citing Sullivan v. Brown, 544 F.2d 279, 286 (6th Cir. 1976)). Hence, UFTA's restraints on alienation, which are designed to protect one class (i.e., creditors) by burdening another class (i.e., debtors), are subject to constitutional review.

The Fourth Amendment, which prevents unreasonable searches and seizures, may limit UFTA to "reasonable" restraints. While it is true that Fourth Amendment cases usually entail an actual physical seizure of persons or property in a criminal context, see, e.g., Hoffman v. People, 780 P.2d 471, 473 (Col. 1989) (discussing the seizure of marijuana plants); State v. Citta, 625 A.2d 1162, 1163 (N.J. Super. Ct. Law Div. 1990) (same), it is equally true that the Fourth Amendment applies to civil cases, including debtor-creditor cases. *See, e.g.*, United States v. James Daniel Good Real Property, 510 U.S. 43, 51 (1993) ("the Fourth Amendment applies . . . in the civil context"); Soldal v. Cook County, Ill., 506 U.S. 56, 61 (1992) (applying "seizure" clause of Fourth Amendment to levy and attachment of judgment debtor's property); Michigan v. Tyler, 436 U.S. 499, 506 (1978) (applying Fourth Amendment to "[s]earches for administrative purposes"). Moreover, the definition of "seizure" is elastic. "A 'seizure' of property . . . occurs when 'there is some meaningful interference with an individual's possessory interests in that property.'" *Soldal*, 506 U.S. at 61 (quoting United States v. Jacobsen, 466 U.S. 109, 113 (1984)). This phrasing is so potentially expansive and malleable

that the Fourth Amendment could easily apply to any "unreasonable" impediments that UFTA visits upon a person's right to use and transfer property.

Moreover, UFTA is economic legislation that exercises the government's police power, and the legislature's right to use the police power is also limited by what is reasonable. This was established by the Supreme Court long ago:

> The police power of a State, while not susceptible of definition with circumstantial precision, must be exercised within a limited ambit and is subordinate to constitutional limitations. It springs from the obligation of the State to protect its citizens and provide for the safety and good order of society. Under it there is no unrestricted authority to accomplish whatever the public may presently desire. It is the governmental power of self-protection, and *permits reasonable regulation of rights and property in particulars essential to the preservation of the community from injury.*

Panhandle E. Pipe Line Co. v. State Highway Comm'n, 294 U.S. 613, 622 (1935) (emphasis added). Arguably it would be reasonable to require transferors to leave all of their assets exposed in order to satisfy the low probability of future demands by persons asserting claims that are bizarre or not otherwise reasonably foreseeable by standards existing at the time of transfer. However, most persons are likely to judge this to be a harsh and unreasonable rule. The likelihood of harm to an unlikely claimant is, by definition, statistically low, and the constrained owner is immediately injured in his right to keep, use and dispose of his property for his own benefit. Additionally, any rule requiring exposure of assets for the sake of unlikely claimants is contrary to established American tort law, which only requires individuals to guard against reasonably foreseeable harm. See, e.g., Wohlford v. American Gas Prod. Co., 218 F.2d 213, 216-17 (5th Cir. 1955), in which the court stated:

> [A] party should not be held responsible for the consequences of an act which ought not reasonably to have been foreseen. In other words, it ought not to be deemed negligent to do or to fail to do an act when it was not anticipated, and should not have been anticipated, that it would result in injury to any one. To require this is to demand of human nature a degree of care incompatible with the prosecutions of the ordinary avocations of life. It would seem that there is neither a legal nor a moral obligation to guard against that which cannot be foreseen, and under such circumstances the duty of foresight should not be arbitrarily imputed.

*Id.* (citing Texas & Pac. R.R. v. Bigham, 38 S.W. 162, 163 (Tex. 1896)). *See also* Dartron Corp. v. UniRoyal Chem. Co., Inc., 893 F. Supp. 730, 738 (N.D. Ohio 1995) (denouncing as "unreasonable" an attempt to impose negligence liability on prior landowner in favor of future landowner because "'such future owners may not be known or even contemplated at the time the [prior] landowner creates or maintains a condition on his or her property'") (citations omitted) (quoting Wellesley Hills Realty Trust v. Mobil Oil Corp., 747 F. Supp. 93, 100 (D. Mass. 1990)); Simmons v. Baltimore Orioles, Inc., 712 F. Supp. 79, 83 (W.D. Va. 1989) (discussing foreseeability and stating that it is "a test of practical likelihood"). Accordingly, the backdrop of traditional tort law enhances the unreasonable appearance of the former rule (i.e., exposing all assets to protect even unlikely claimants),, while it makes the latter rule (i.e., protecting only against reasonably foreseeable claimants) seem ever the more reasonable.

Because of these and other considerations, UFTA is probably constitutionally infirm if it requires transferors to do more than protect against reasonably foreseeable creditors with claims in reasonably foreseeable amounts.

b. *What is Reasonable?*

The next question, of course, is what is reasonable? This is ultimately determined by the trier of fact.[187]

A "rule of reason" approach inherently forbids transferors from engaging in groundless speculation as to the value of future assets or debts. Wild guesses are by definition unreasoned, and transferors should not be allowed to build shelters based on illogical or groundless assumptions as to their future affairs. But transferors who engage in speculation based on realistic considerations ought to be deemed as acting reasonably. In assessing whether the transferor has reasonably calculated her future obligations and the proper amounts she may shelter, the fact finder should be instructed to consider any relevant facts which reveal the transferor's intent.[188] A nonexclusive list of possible factors might include the following:

1. What is the nature of the transferor's business?[189]
2. Is the transferor's income stable or volatile?
3. What is the likelihood of future growth or contraction in the transferor's business?
4. What are the transferor's current secured and unsecured debts?
5. In connection with secured debt, is the collateral likely to retain, gain, or lose value?
6. Is the transferor likely to incur substantial consensual debt in the future (e.g., large bank loans)?
7. If the transferor has signed any guarantees, what is the likelihood that the primary debtor will default?
8. What are the transferor's spending and saving habits?

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[187]*See, e.g.*, 3 DEVITT ET AL., *supra* note 180, §§ 80.01, 80.03 (instructing jury on "reasonably prudent person" standard in a negligence action); *id.* § 85.14 (instructing jury of its duty to determine "reasonable" damages in personal injury cases); *id.* § 90.17 (implementing antitrust law's "rule of reason" and instructing the jury that "[i]t is for you to decide whether the evidence in this case shows an unreasonable restraint"); *id.* § 103.09 (instructing jury of a defendant's right to assert a "reasonable belief and good faith" defense in civil rights cases under 42 U.S.C. § 1983 (1994)).

[188]UFTA § 4, cmt. 6 states, "[A] court should evaluate all the relevant circumstances . . . . Thus the court may appropriately take into account all indicia negativing as well as those suggesting fraud." UFTA § 4, cmt. 6, 7A U.L.A. at 654-56. *See also* FED. R. EVID. 401-402 (defining "relevant").

[189]For example, a person of inherited wealth whose primary occupation is managing his own portfolio is likely to incur substantially lower risk than an obstetrician.

9. What is the composition of the transferor's asset portfolio? Is her portfolio balanced? Does the transferor disproportionately invest in high risk equities? Is she a conservative investor? And, if so, is she too conservative?
10. What is the transferor's track record of prior incidents and claims?
11. How much insurance does the transferor have?
12. What type of insurance coverage does the transferor have? Are there any significant exclusions?

Depending upon the facts and circumstances existing at the time of transfer, many of these factors could be very probative in determining the reasonableness of the transferor's LRSC calculations.

When estimating future assets and liabilities, a transferor should also reasonably discount the likelihood that certain assets or liabilities will materialize. For instance, a transferor might buy a one dollar ticket every day for a state-sponsored million dollar lottery, in which her odds of winning $1 million are extremely slim. A planner might reasonably assume that, over the next twenty years, the transferor's lifetime odds of winning that amount are, at best, one tenth of one percent (0.1%). Under these circumstances, a transferor could not reasonably claim millions of dollars in likely future income due to her gaming habits. Simple probability indicates that her odds of hitting the $1 million lottery, when discounted for her likelihood of success, yield a contingent asset with a maximum value of $1,000.[190] This is the most that should be included in the LRSC as a result of the transferor's gambling. In contrast, there is a 100% chance that the transferor will spend a dollar a day for twenty years. This means that the LRSC should account for a certain expense of $7,300.[191]

Of course, this sort of discounting works both ways. Just as creditors can rightly argue that future assets (like lottery income) should be discounted, transferors should be entitled to discount possible future risks. For instance, the odds of a transferor having a $1 million car wreck are probably very low. For illustration purposes, it will be assumed that there is only a three percent probability that this will eventually occur. Based on these figures, the LRSC should not account

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[190] ($1,000,000)(0.1%) = ($1,000,000)(0.001) = $1,000. This calculation is an example of simple probability discounting and does not use any present value discounting to reflect the time value of the money spent on lottery tickets over many years.

[191] ($1)(365 days)(20 years) = $7,300. To be technically correct, the $7,300 expense should be reduced to its present value in order to reflect the time value of money.

for a future $1 million claim, but should only post a maximum liability of $30,000.[192] At the same time, if the transferor has a $3 million auto policy, she benefits from a very high likelihood that the policy will cover claims arising from that accident. Absent extraordinary circumstances, the odds can safely be assumed to be near 100% that the insurer will cover these claims.[193] When analyzing the LRSC on these facts, the calculations should include a $30,000 contingent claim and a corresponding $30,000 contingent asset based on the transferor's insurance coverage.[194]

The practice of discounting assets and liabilities has been accepted by courts and commentators reviewing fraudulent transfers issues.[195] Such discounting practices also exist in other areas of the law. For instance, in eminent domain and condemnation cases, courts routinely instruct the fact finder to "take into consideration all elements of

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[192]($1,000,000)(3%) = ($1,000,000)(.03) = $30,000.

[193]Examples of extraordinary circumstances that might reduce this 100% probability are the onset of financial instability for the insurer or driver conduct that activates the intentional tort exclusion in her coverage.

[194]The typical policy will pay only for the damages incurred. Hence, if the claim is for $30,000, the payout will only be $30,000, even though the policy limits are 100 times that amount. It would, therefore, be inappropriate to include a contingent asset in excess of $30,000. A transferor who wishes to be ultra-conservative in calculating the transferable surplus could increase the odds of a crash, thereby increasing the contingent debt. The planner could also reduce the likelihood that the insurer will pay, thus reducing the LRSC's surplus assets to some degree. However, since insurers usually pay, the discount for nonpayment would typically be a very minor percentage. A more realistic concern is whether the client's policy limits are high enough.

[195]*See, e.g.*, Covey v. Commercial Nat'l Bank of Peoria, 960 F.2d 657, 660 (7th Cir. 1992) (stating that "[d]iscounting a contingent liability by the probability of its occurrence is good economics and therefore good law, for solvency, the key to [11 U.S.C.] § 548(a)(2), [i.e., constructive fraud] is an economic term"); Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 648-49 (3d Cir. 1991) (deciding that debtor's guarantee liability should be reduced below face value due to presence of co-guarantors); *In re* Xonics Photochemical, Inc., 841 F.2d 198, 199-201 (7th Cir. 1988) (explaining the rationale behind discounting contingent liabilities); SPERO, *supra* note 1, ¶ 3.04[1][c][ii] (stating that "[u]nder the Bankruptcy Code, which is similar to the UFTA, contingent liabilities are discounted to reflect the probability that the contingency will materialize"). Moreover, it is the debtor's perspective that counts in assessing the odds that a given liability will materialize. *See Covey*, 960 F.2d at 660. This allows transferors some leeway for honest and good faith maneuvering. Using the debtor's perspective for discounting purposes sharply contrasts with the test for REV, which requires the creditor's viewpoint. *Mellon Bank*, 945 F.2d at 646 (presence or absence of REV to be tested from creditors' perspective); *In re* Agricultural Research & Tech. Group, Inc., 916 F.2d 528, 540 (9th Cir. 1990) (citing UFTA § 3, cmt. 2 and stating that "[a]ny consideration not involving utility for the creditors does not comport with the statutory definition [of value]"); *In re* Dondi Fin. Corp., 119 B.R. 106, 109 (Bankr. N.D. Tex. 1990) (mandating that "fair consideration" under UFCA "must be determined from the standpoint of creditors").

value."[196] In cases involving condemnations of subsurface mineral interests, this has sometimes led to the use of "in the ground" sales prices for minerals in place, which involves unit prices (e.g., price per mineral ton or per barrel of oil) that are less than the price per unit of recovered minerals at the surface.[197] These "in the ground" prices inherently reflect a discount for the risk of nonrecovery, although one is hard pressed to find a court that will expressly admit to this reality. In other settings, courts allow damage awards for lost profits that could have been recovered but for the injuries allegedly caused by a defendant, provided the damages can be proven with "reasonable certainty."[198] Expert opinions, which are based on a "reasonable degree of certainty,"[199] are inherently probabilistic. An expert usually asserts his view in terms of the probability of certain facts being true. Even more expressly, at least one Canadian court, in a wrongful death case, calculated damages in a way that explicitly considered a wide range of independent and dependent variables, including the widow's likelihood of remarriage.[200] In summary, the use of probabilities is well established and there is no reason why this approach cannot be applied to the LRSC.[201]

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[196]*See, e.g., Instructions to Commissioners Under Rule 71A*, 61 F.R.D. 503, 511 (1973) (setting forth model condemnation instructions).

[197]*See, e.g.*, United States v. 2847.58 Acres of Land, 529 F.2d 682, 685-86 (6th Cir. 1976) (regarding oil); United States v. 1629.6 Acres of Land, 360 F. Supp. 147, 151 (D. Del. 1973) (regarding sand and gravel). For instance, in *1629.6 Acres*, the price was stated in terms of value for gravel in place, and was also further discounted by 50% in order to account for the risk of competitive pressures in the market place. *1629.6 Acres*, 360 F. Supp. at 151.

[198]*See, e.g.*, AGF, Inc. v. Great Lakes Heat Treating Co., 555 N.E.2d 634, 638 (Ohio 1990) (holding that new businesses may recover damages for lost profits if they are proven with reasonable certainty); Charles R. Combs Trucking, Inc. v. International Harvester Co., 466 N.E.2d 883, 887 (Ohio 1984) (same).

[199]*See, e.g.*, Yates v. Chicago Nat'l League Ball Club, Inc., 595 N.E.2d 570, 580 (Ill. App. Ct. 1992) (allowing expert testimony when based on a reasonable degree of certainty).

[200]Sharp-Barker & Barker v. Fehr, 39 B.C.L.R. 19 (S. Ct. Brit. Col. 1982).

[201]Indeed, the use of probability discounting is in many ways better suited to the LRSC than to some of the examples cited above. For instance, in lawsuits, experts and fact finders are blessed with the perspective of hindsight and, due to pre-trial discovery, are frequently given mountains of evidence that enable them to reconstruct events. Despite these advantages, experts are still allowed to state opinions as to liability, causation and damages based on a "reasonable degree" of certainty, not 100% certainty, and juries are usually told that they may award substantial damages if it is merely "more likely than not" that the defendant injured the plaintiff. This is probabilistic analysis, even though all the facts are ostensibly available and the need for guesswork is considerably reduced. In contrast, a planner and his client do not benefit from hindsight. Instead, they are forced to gaze into an uncertain future, and unavoidably engage in speculative assessments. It, therefore, seems only fair that they be allowed the same right to engage in probabilistic assessments that is conferred upon those granted the luxury of hindsight.

### C. *Case Law: Financial Reserves and the Right to Transfer Surplus Assets*

In dealing with the LRSC and the issue of actual future fraud, one of the key issues is the debtor's intent at the time of the transfer. Several leading cases have adopted a three-prong test for proving fraudulent transfers which requires that "there must be: [1] a creditor to be defrauded, [2] a debtor intending fraud, and [3] a conveyance of property which is applicable by law to the payment of the debt due."[202] In such cases, "[a] fraud upon creditors consists in the intention by the debtor to prevent his creditors from recovering their just debts by withdrawing his property from the reach of his creditors."[203] However, debtors who retain reserves have not "withdraw[n] . . . property from the reach of . . . creditors."[204] On the contrary, such debtors have protected legitimate creditors via a programmatic effort to cover reasonably foreseeable debts, which is generally inimical to claims that a debtor acted with intent to defraud or otherwise harm creditors. Since intent is the key, the law upholds transfers made out of what were believed to be surplus assets.[205] Consequently, debtors who make good faith efforts to observe the

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[202]*In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 391 (Bankr. S.D. Fla. 1991); *accord* Gilbert v. Armstrong Oil Co., Inc., 561 So. 2d 1078, 1082 (Ala. 1990) (adopting a three-prong test with language the closely parallels the *In re Miami* elements); Eurovest, Ltd. v. Segall, 528 So. 2d 482, 483 (Fla. Dist. Ct. App. 1988) (same); and cases cited in *supra* notes 23, 25. *See also* UFTA § 4(a)(1), 7A U.L.A. at 652 (requiring "actual intent to hinder, delay, or defraud"). In some cases, the first prong may be a significant issue. The plaintiff may not be a "creditor" under UFTA because his suit may be predicated on a legal theory that does not amount to a legally cognizable "claim." See *supra* notes 65 and 108 regarding the definition of "claim." In other cases, the third prong may be a serious battleground. The plaintiff may be seeking to attach property that the debtor claims is legally exempt from attachment in any event. However, for present purposes, the discussion will focus on the second prong of intent.

[203]*In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 392 (Bankr. S.D. Fla. 1991) (quoting Bay View Estates Corp. v. Southerland, 154 So. 894, 900 (Fla. 1934), *overruled on other grounds*, Lott v. Padgett, 14 So. 2d 667 (Fla. 1943)) (emphasis omitted).

[204]*Id.* at 392 (quoting *Bay View Estates Corp.*, 154 So. at 900, *overruled on other grounds*, Lott v. Padgett, 14 So. 2d 667 (Fla. 1943)).

[205]Indeed, courts uphold transfers despite the fact that debtors miscalculated, suffered unforeseen setbacks, or otherwise made honest mistakes in assessing their long range solvency. *See, e.g.*, Phoenix Bank v. Stafford, 89 N.Y. 405, 408 (N.Y. Ct. App. 1882) (finding that debtor's overstatement of assets resulted from his failure to properly factor in uncollectible accounts and not his intent to defraud his creditors); Creed v. Lancaster Bank, 1 Ohio St. 1 (1852) (upholding the validity of a transfer of a solvent business which became insolvent four years after the conveyance); see also Schreyer v. Platt, 10 S. Ct. 579, 582 (1890), in which the Court, while upholding certain transfers as valid, made much of the fact that the debtor's setback "was one of those vicissitudes unexpected and unlooked for— not planned for— and doubtless an astonishment to all the parties." *Id.*

principles of the LRSC are not acting with intent to defraud, even if their calculations later prove to be erroneous.[206]

The LRSC is premised on the notion that debtors may transfer their surplus funds into shelters without violating the fraudulent transfers law. Hence, if the debtor retained enough assets to cover his liabilities, or merely had good reason to believe that he could cover his future debts, then the debtor's prior transfers are not amenable to later attack on grounds of fraudulent intent. This has long been recognized in federal law by no less an authority than the Supreme Court.[207]

Cases under state law also support this proposition. For instance, in Ohio, this sort of reserve theory has long been recognized. In *Creed v. Lancaster Bank*,[208] the Ohio Supreme Court reversed and remanded a lower court decision against the debtor in proceedings that attacked the validity of certain gifts of stock to the debtor's children and others.[209] In so doing, the court noted that the stock transfers were made by the debtor "before his embarrassments commenced, and whilst he considered himself, and was regarded by the community, as a wealthy man."[210] Also, at the time of the transfers, the debtor was "a man of large

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[206]*See supra* note 204. Note that insolvency could raise problems of constructive fraud, which focuses upon economic effect, but that is a different issue which is essentially unconcerned with intent. *See* UFTA § 4(a)(2), 7A U.L.A. at 653; *see also supra* notes 20, 23.

As an aside, note that it is theoretically possible to remain solvent yet transfer assets with unlawful fraudulent intent. For example, a debtor could embark upon a scheme to defraud that is interrupted before it is consummated. However, if a scheme fails to render the transferor insolvent, it would probably be difficult to prove that the transferor acted with bad intent. Although neither solvency or insolvency is conclusively dispositive of intent, it is "relevant evidence." *See* UFTA § 4, cmt. 5, 7A U.L.A. at 654 (noting that any badge of fraud is "relevant evidence" but that no presumptions arise from the presence of any particular badge); *see also* Roland v. United States, 838 F.2d 1400, 1403 (5th Cir. 1988) ("Under the intent test referred to above, whether . . . [the debtor] was solvent at the time of the transfer is not dispositive. The crucial element was his *intent* at that time."). Consequently, at trial, a fraudulent transferor might lie about his real motives and point to his solvency as proof that he lacked fraudulent intent, and a judge or jury might accept such a mendacious tale. Fortunately, such an unethical scenario is unlikely to ever come to pass. The transferor would still have adequate assets left in his name, and his creditors are likely to have seized and attached such property long before a fraudulent transfers claim would be tried. Further, upon seizing those assets, and thus satisfying their claims, the transferor's creditors will lose any practical incentive, as well as any legal standing to attack other transfers. *See* Wynne v. Boone, 191 F.2d 220, 225 (D.C. Cir. 1951).

[207]See, e.g., Schreyer v. Platt, 10 S. Ct. 579 (1890), which, in the course of upholding transfers against claims by subsequent creditors, repeatedly observed that the debtor was solvent at the time of transfer.

[208]1 Ohio St. 1 (1852).

[209]*Id.* at 2-3.

[210]*Id.* at 4.

property, prosperous, and unembarrassed in all his business; able to pay his debts when called for, and did pay them."[211] In other words, the debtor had ample reserves to cover his debts at the time of transfer. Consequently, the finding that invalidated the transfers was reversed.[212]

This type of reserve theory is also accepted by contemporary Ohio courts, even in connection with transfers made in the face of claims by present creditors. In *Fifth Third Bank of Columbus v. McCloud*,[213] an Ohio appellate court recognized that transfers can be made in the face of present claims if adequate reserves are created.[214]

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[211] *Id.* at 9.

[212] Creed v. Lancaster Bank, 1 Ohio St. 1, 15 (1852).

[213] 628 N.E.2d 131 (Ohio Ct. App. 1993).

[214] Fifth Third Bank of Columbus v. McCloud, 628 N.E.2d 131, 134 (Ohio Ct. App. 1993), wherein the court stated, "We have previously noted that '[a] person largely indebted cannot make a voluntary conveyance of his property without the most careful regard for the rights of his creditors. Such a conveyance is void as to existing creditors, *unless property is retained, clearly and beyond doubt, sufficient to pay all the grantor's debts*, for it is considered to be in fraud of such creditors.'" *Id.* (quoting Cellar Lumber Co. v. Holley, 224 N.E.2d 360, 363 (Ohio Ct. App. 1957) (emphasis added) (alteration in original).

*Fifth Third Bank*'s holding is right as a matter of substantive law. A debtor can make transfers if reserves are retained to cover existing debts. *Accord* Crumbaugh v. Kugler,* 2 Ohio St. 373, Syl. Par. 1 (1853) ("A person largely indebted cannot give away his property without amply providing for the payment of his debts."). However, to the extent that *Fifth Third Bank* suggests that the debtor must ultimately prove the adequacy of reserves, this case is wrong as a matter of evidentiary law. It is not up to the debtor to prove "clearly and beyond doubt" that he has retained adequate reserves. At worst, the presence of reserves is an affirmative defense that should be proven by a mere preponderance. Moreover, good reason to make the absence of adequate reserves an issue that must be proven by the plaintiff as part of his broader need to prove fraudulent intent.

A plaintiff claiming actual fraud must show that a challenged transfer was made with intent to hinder, delay, or defraud creditors. UFTA § 4(a)(1), 7A U.L.A. at 652. A lack of adequate reserves is simply another indicator that the defendant-transferor was not solvent, and insolvency is a badge of fraud. *Id.* § 4(b)(9), 7A U.L.A. at 653. Ultimately, the badges of fraud are merely objective facts that the fact finder may use to make inferences about the debtor's intent at the time of transfer, but there is no requirement that any particular inferences be drawn. *Id.* § 4, cmt. 5, 7A U.L.A. at 654 ("Proof . . . [as to] any one or more of the factors enumerated in subsection (b) may be relevant evidence as to the debtor's actual intent but does not create a presumption [of fraud]."); *see also* Stein v. Brown, 480 N.E.2d 1121, 1124 (Ohio 1985) (noting longstanding use of inferences). Consequently, a plaintiff may argue that a lack of reserves shows fraudulent intent, but since insolvency is inconclusive proof of intent, the fact finder may overlook a lack of adequate reserves if so inclined. Under these circumstances, it is wrong to state that defendant must prove the adequacy of his reserves, as the law clearly states that insolvency is not conclusive proof of anything.

*Note that, in Ohio, courts frequently provide a court-authored syllabus, and the syllabus is routinely cited as the law of the case. *See, e.g.*, Mominee v. Scherbarth, 503 N.E.2d 717, 731 (Ohio 1996) (Douglass, J., concurring).

A similar result was reached in *Cresho v. Cresho*,[215] which involved a divorced husband who owed various support obligations to his ex-wife.[216] The mother of the ex-husband gave her son title to a parcel of real property.[217] The ex-husband then obtained a bank loan that was secured by that property and promptly reconveyed the property to his mother via a quitclaim deed.[218] Neither of the transactions between mother and son were supported with monetary consideration.[219] The ex-wife sought to reverse the transfer back to the mother so that she could levy on the house, in order to collect on a domestic relations support judgment.[220] However, the court found that the ex-husband had adequate assets in yet another piece of property, specifically the old marital

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Moreover, *Fifth Third Bank*'s approach is contrary to the established rule that the plaintiff must prove fraud. It is not up to defendant to disprove fraud. Cases both in and out of Ohio confirm that the plaintiff bears the ultimate burden of persuasion. Sometimes these cases require the plaintiff to prove fraud by a mere preponderance, and other times they require proof by an elevated "clear and convincing" standard, particularly if equitable relief is sought. Either way, though, it is well established that the plaintiff must prove wrongdoing. *See, e.g.*, United States v. Berman, 884 F.2d 916, 921 (6th Cir. 1989) (holding that "clear and convincing" evidence of actual fraud was required); Malloy v. United States, 743 F. Supp. 834, 838 (S.D. Fla. 1990) (stating that the party alleging fraudulent transfer bears burden of proof); *In re* Erin Food Servs., Inc., 117 B.R. 21, 25 (Bankr. D. Mass. 1990) ("clear and convincing" required by New Hampshire law); Tessitore v. Tessitore, 623 A.2d 496, 498 (Conn. App. Ct. 1993) (determining that clear and convincing proof is needed to show a fraudulent transfer and that the burden of proof is on the "party who seeks to set aside a conveyance"); *Stein*, 480 N.E.2d at 1124 ("The burden of proof in an action to set aside a fraudulent conveyance must be affirmatively satisfied by the complainant."); McKinley Fed. Sav. & Loan v. Pizzuro Enters., Inc., 585 N.E.2d 496, 499 (Ohio Ct. App. 1990) (stating that plaintiff must show clear and convincing proof if equitable relief is sought); Potts v. Adams, 90 N.E.2d 703, 705 (Ohio Ct. App. 1949) (finding that plaintiff carries the burden of proof); Hughey v. Lind, 758 P.2d 431, 433 (Or. Ct. App. 1988) (concluding that plaintiff must muster a preponderance). Perhaps, under certain circumstances, a plaintiff might mount a good *prima facie* case, thereby shifting the burden of going forward with the evidence to the defendant. Cresho v. Cresho, 646 N.E.2d 183, 186 (Ohio Ct. App. 1994). However, shifting the burden of going forward differs radically from shifting the ultimate burden of persuasion. This latter burden stays upon the plaintiff throughout the case. Morris v. Nance, 888 P.2d 571, 576 (Or. Ct. App. 1994) (holding that the burden of persuasion remains with the plaintiff). Accordingly, *Fifth Third Bank* mistakenly suggests that the transferor must show the adequacy of reserves in order to validate a transfer.

[215]646 N.E.2d 183 (Ohio Ct. App. 1994).

[216]*Id.*

[217]*Id.* at 184.

[218]*Id.* at 185.

[219]*Cresho*, 646 N.E.2d at 184-85. Although neither transaction between mother and son was supported by monetary consideration, the stated consideration of the first conveyance, from mother to son, was "love and affection." *Id.*

[220]*Id.*

homestead.[221] Consequently, the court found no fraud in the ex-husband's reconveyance of the first parcel to his mother.[222]

Opinions from other jurisdictions also embrace reserve theory under various circumstances, including cases alleging actual fraud as to both present and future creditors, and cases dealing with constructive fraud. In the New York case of *Phoenix Bank v. Stafford*,[223] a husband conveyed property to his wife, but at a time when his personal assets exceeded liabilities.[224] Also, his partnership's assets exceeded firm liabilities at the time of transfer.[225] When the transfer was later challenged, the court held that the evidence did not sustain a finding that the transfer to his wife was made with intent to defraud partnership creditors.[226] In reaching its conclusion, the court relied heavily on the fact that the debtor and his partnership both had adequate surpluses at the time of transfer.[227]

In the West Virginia case of *Kanawha Valley Bank v. Wilson*,[228] the court held that transfers by debt-free husbands to their wives or children "will not for that cause alone be deemed fraudulent even to subsequent creditors . . . especially if the . . . [transfer] is only of an inconsiderable amount of the husband's estate. . . . It must depend upon the value of the property conveyed, compared with his whole estate, and his pecuniary circumstances at the time."[229] Florida holds that secured creditors who have adequate security may not challenge allegedly fraudulent transfers of other property.[230] This means that creditors who can satisfy their demands out of some of the debtor's property have no right to complain about what the debtor may do with the rest of his property.[231]

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[221] *Id.* at 185.

[222] *Id.* at 187. The appellate court stated, "It follows that, if . . . [the ex-husband's] interest in the marital home is sufficient to satisfy . . . [the ex-wife's] creditor claims, then [the ex-husband] was not rendered insolvent by the transfer of the [other] property" to his mother. *Id.*

[223] 89 N.Y. 405 (N.Y. Ct. App. 1882).

[224] *Id.* at 407.

[225] *Id.* at 408.

[226] *Id.*

[227] Phoenix Bank v. Stafford, 89 N.Y. 405, 407-08 (N.Y. Ct. App. 1882).

[228] 25 W. Va. 242 (W. Va. 1884).

[229] *Id.* at 255-56.

[230] Rosenberg v. Aarnel Funding Corp., 575 So. 2d 753, 753 (Fla. Dist. Ct. App. 1991), wherein the court stated, "Because the collateral . . . pledged . . . was more than sufficient to secure payment of the obligation owed . . ., the transfers in question cannot be set aside as fraudulent. . . . [I]f security was ample at time of alleged fraudulent transfer, imputation of fraud from debtor's voluntary conveyance of other property will not obtain." *Id.* (citing Bay View Estates Corp. v. Southerland, 154 So. 894 (Fla. 1934)).

[231] Another Florida court also endorsed the notion that transfers are permissible if the

The Court of Appeals for the D.C. Circuit reached a similar conclusion when it said, "If the debtor in good faith wishes to satisfy the debt or judgment from assets not involved in the conveyance, he is no doubt free to do so, and the creditor on receipt of payment will lose any standing to prosecute the suit to set aside the conveyance."[232] In Arkansas, courts have long distinguished "between actual insolvency and mere indebtedness."[233] Solvent transferors are entitled to make transfers, even if they are heavily indebted, provided their remaining assets exceed their liabilities.[234]

In Illinois, the elements of constructive fraud expressly include the debtor's failure to retain enough assets to cover his debts.[235] The necessary implication of this view is that adequate reserves will defeat claims of constructive fraud. Illinois reaches a similar result as to actual fraud, which, under that state's law, consists in part of "a voluntary transfer without consideration" that "impair[s] the rights of creditors."[236] This, too, implicitly ratifies transfers made by clients who retain adequate reserves, for those reserves act to protect creditor rights.

In a North Dakota legal malpractice action, a client sued an attorney for damages arising from the attorney's failure to transfer a parcel from husband to wife for "love and affection" only, and which otherwise lacked consideration.[237] The attorney defended on various grounds, including an argument that the proposed transfer would have

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debtor retains adequate reserves. In *In re* Mart, 88 B.R. 436 (Bankr. S.D. Fla. 1988), the court refused to unravel a transfer made by debtors to their daughter within one year of the debtors' bankruptcy filing. The court cited various factors to justify its conclusion, including the fact that the transfers in question amounted to less than 10% of the debtors' net assets at the time of transfer and that the debtors had a substantial net surplus of approximately $4 million remaining after the transfer. *Id.* at 439.

[232]Wynne v. Boone, 191 F.2d 220, 225 (D.C. Cir. 1951). *Accord* Allard v. DeLorean, 884 F.2d 464, 466 (9th Cir. 1989) (holding that release or satisfaction of claim causes creditor to lose standing).

[233]Bank of Sun Prairie v. Hovig, 218 F. Supp. 769, 777 (W.D. Ark. 1963). The Commissioners approvingly cite *Bank of Sun Prairie* at UFTA § 4, cmt. 6(i), 7A U.L.A. at 656.

[234]*Bank of Sun Prairie*, 218 F. Supp. at 776-77.

[235]Stoller v. Exchange Nat'l Bank of Chicago, 557 N.E.2d 438, 444 (Ill. App. Ct. 1990), in which the court stated that the three elements of constructive fraud (called "fraud in law" in Illinois are: (1) "a voluntary gift," (2) "an existing or contemplated indebtedness," and (3) "a failure of the debtor to retain sufficient assets to pay the indebtedness." *Id.* The bankruptcy court in *In re* Grabill Corp., 121 B.R. 983, 997 (Bankr. N.D. Ill. 1990), also adopted this three-prong test and cited additional Illinois cases to support this legal conclusion.

[236]Tcherepnin v. Franz, 475 F. Supp. 92, 96 (N.D. Ill. 1979). Predictably, intent is also an element of actual fraud in Illinois. *Accord In re Grabill*, 121 B.R. at 996-97 (applying UFCA).

[237]Bjorgen v. Kinsey, 466 N.W.2d 553, 560 (N.D. 1991).

been a fraud on creditors.[238] The court disagreed and specifically noted that the parcel would still be adequate security for a bank debt, and that the transfer would not cause insolvency in any event.[239]

Massachusetts courts have long held that debtors may make transfers, including transfers designed to protect property against future business hazards, provided the debtor is generally solvent and has not embarked on a plan to intentionally overextend himself after making conveyances.[240] The Massachusetts view comports with long-

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[238] *Id.*

[239] *Id.*

[240] For example, in Winchester v. Charter, 94 Mass. (12 Allen) 606, 609 (1866), the court stated:

> [I]t could not be properly adjudged that a voluntary conveyance was fraudulent and void, either as against existing or subsequent creditors, if it was proved to have been made by a person substantially free from debt, and possessed of a large amount of property, who had no purpose to hinder or delay the creditors, and whose sole motive was to transfer the property for the benefit of his wife or children, so that it should not remain at the hazard of business or be subjected to the risk of improvidence.

*Id.* Likewise, in Stratton v. Edwards, 54 N.E. 886, 887 (Mass. 1899), the court stated,

> [I]t must appear that the conveyances were made with "an intent on the part of the grantor to contract debts, and a design to avoid payment of such debts by the conveyance of his property"; and, to establish such an intent, it is not enough to show that the grantor had a general purpose to secure the property from the hazards of future business and the claims of future creditors, but it must appear that at the time of the conveyance he had an actual intent to contract debts, and a purpose to avoid the payment of them by the conveyance.

*Id.* In more contemporary times, a Massachusetts court provided similar reasoning in dicta. In MacNeil v. MacNeil, 43 N.E.2d 667 (Mass. 1942), a husband embarked on financially risky undertakings and was involved in litigation. *Id.* at 668. He put real property into his wife's name, and made later improvements to the property. In connection with a subsequent marital separation, the husband sued the wife to get the property back. *Id.* The trial court found that the effect of the transfer was to "secure[ ] [the property] from attack by his creditors or claimants." *Id.* at 669. However, the husband claimed his intent was to provide for his family, and objected to the trial court's finding "as one to the effect that the transaction was in fraud of his creditors." *Id.* The appellate court stated that there was "no evidence . . . that the conveyance in question was in fraud of the . . . [husband's] creditors," primarily because there was no proof that, at time of transfer, the husband was "indebted beyond his probable means of payment." *Id.* In other words, the husband's apparent ability to satisfy likely future debts out of other assets rendered the transfer nonfraudulent.

*MacNeil* is also interesting because it shows the importance of characterizing a transferor's intent. The husband in *MacNeil* argued that he was not acting to defraud creditors, but was instead acting with intent to protect his family, which is a more altruistic and acceptable motive. Logically, there is no reason why the two types of motives cannot coexist. A debtor may seek to provide for his family by defrauding or injuring legitimate creditors. However, when family concerns appear paramount, courts and juries sometimes overlook the possible coexistence of benevolent and malevolent intent, as shown in *MacNeil* and other cases.

standing federal law, which also permits transfers by solvent persons who wish to guard against unpredictable business hazards but who are not intending to overextend themselves.[241]

Finally, in Maryland, it has long been held that debtors not intending fraud could transfer their property, even as against present creditors, provided they were "prosperous."[242] This is simply another way of saying that the debtor had adequate reserves to cover his present debts.

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In another example, Higgins v. Johnson, 20 Tex. 389 (1857), a husband emigrated to Texas from New York in 1840 and was apprehensive about old debts from New York. *Id.* at 395. In 1846, still fearing New York creditors, the husband bought real property and put it in his wife's name in order to provide for his wife and family in case New York creditors tried collecting. *Id.* at 390-91. Here, the fear was past debts, not future ones, but the motive was still familial. Subsequent Texas creditors, whose claims arose after the transfer to the wife, tried to execute on the land. *Id.* at 390. The court held that wife's heirs were entitled to the land over the Texas creditors, because "[t]he evidence showed to the satisfaction of the jury, and we think pretty clearly, that the husband intended to make to her a gift of the . . . [land]. He was apprehensive of trouble from old debts in New York, and . . . he wanted his wife to have something for the benefit of the family . . . ." *Id.* at 395.

Likewise, in Klein v. Klein, 112 N.Y.S.2d 546 (1952), the husband, a retired Buffalo policeman, placed real estate in his wife's name during his tenure of police duty. *Id.* at 547. Upon retirement, and pursuant to verbal agreement, he asked his wife to reconvey the property back to him, but she refused. *Id.* at 548. The husband sued the wife to enforce the verbal agreement. *Id.* at 547. The parties stipulated that the transfer to the wife was not made with intent to defraud creditors. *Id.* The court found that, although no current liabilities afflicted the husband at time of transfer, he was nonetheless in fear of possible suit, such as "false arrest or some other act in connection with his duties" as a policeman. *Id.* at 547. Buffalo had no insurance or other provisions to protect its policemen from such lawsuits. *Id.* Accordingly, the husband made this transfer in order to preserve a home for their three incompetent children in the event the husband was sued. *Id.* The court called this plan "most reasonable," and then said of the husband: "Surely his hands were as clean as any one who ever came into equity. What he did amounted to no more than insurance against a possible disaster." *Id.* at 548.

Two words of caution are in order about *MacNeil* and *Klein*. First, neither case had a creditor alleging fraudulent transfer, so they are not directly on point. Second, these husband-wife disputes show the danger of placing assets in a spouse's name. The spouse may later try to keep the property as his or her own, despite any contrary understandings that may have been reached at the time of transfer.

[241]In Schreyer v. Platt, 10 S. Ct. 579, 582 (1890), the Court approvingly quoted Carr v. Breese, 81 N.Y. 584, 588 (1880), for the proposition that the debtor "had done no more than any business man has a right to do, to provide against future misfortune when he is abundantly able to do so." Id. *Schreyer*, however, should not be taken as unbridled authority for businessmen to make transfers to protect against future business misfortune. The debtor in *Schreyer* made transfers while solvent and suffered only unexpected reverses, as opposed to reasonably foreseeable setbacks.

[242]Williams v. Banks, 11 Md. 198, 227 (1857). The court also stated that "'a voluntary conveyance may be valid against existing creditors if there is no actual fraud intended, and the grantor is in prosperous circumstances.'" *Id.* (citation omitted) (quoting Salmon v. Bennett, 1 Conn. 525, 547-48 (Conn. 1816)).

The importance of these cases is clear. Debtors who maintain adequate reserves to cover present debts and reasonably foreseeable future debts may do what they wish with their surplus, thereby validating the basic premise of the LRSC. Any other conclusion would render life unworkable for most Americans. As a matter of day-to-day living, virtually everybody disposes of assets even though they are normally indebted to other persons. Such dispositions can include outright gifts, which are often made to close friends or relatives and are totally unsupported by consideration. Nonetheless, these transfers are permitted without dispute, provided that the transferor has maintained adequate reserves or is otherwise capable of meeting his obligations.[243]

This reality has led a Florida court to state that:

> "[t]he mere fact that a person may be indebted to another does not render a conveyance of his property a fraud in law upon his creditors. The owner of property, whether real or personal, possesses the absolute right to dispose of all or any part of his property as he sees fit. The only restriction imposed by law is that no transfer shall be made *which will interfere with the existing rights of other persons.*"[244]

A debtor may, therefore, lawfully make any transfer, whether or not supported by consideration, provided that the transferor protects the existing rights of creditors by retaining assets sufficient to satisfy their claims. The property held in reserve will deprive a creditor of his right to challenge the transferor's disposition of other assets.[245]

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[243]*See supra* notes 207-41 and accompanying text.

[244]*In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 392 (Bankr. S.D. Fla. 1991) (quoting Bay View Estates Corp. v. Southerland, 154 So. 894, 900 (Fla. 1934), *overruled on other grounds*, Lott v. Padgett, 14 So. 2d 667 (Fla. 1943)) (emphasis added by bankruptcy court) (alteration in original). *See also Winchester*, 94 Mass. at 611, in which the court stated:

> No voluntary conveyance can be made which may not in certain contingencies tend to put property beyond the reach of creditors of the grantor, and the happening of such contingencies may be reasonably supposed to be within the contemplation of every person who does not intend to withdraw himself from the active pursuits of life. But such a conveyance is not for that reason void as against subsequent creditors, unless it is also shown to have been made with a design to defraud them . . . .

*Id.*

[245]*See, e.g.*, Wynne v. Boone, 191 F.2d 220, 225 (D.C. Cir. 1951) (concluding that "[i]f the debtor in good faith wishes to satisfy the debt or judgment from assets not involved in the conveyance, he is no doubt free to do so, and the creditor on receipt of payment will lose any standing to prosecute the suit to set aside the conveyance").

### D. *UFTA's Statutory Badges of Fraud: More on Financial Reserves and the Right to Transfer Surplus Assets*

By attempting to provide adequate financial reserves, the LRSC acts to negate some important statutory badges of fraud, which further prevent inferences of fraudulent intent.

Perhaps most notably, the LRSC negates section 4(b)(9), which deals with a debtor's solvency in the wake of a transfer.[246] Section 4(b)(9) specifically addresses whether a "debtor was insolvent or became insolvent shortly after the transfer was made."[247] Therefore, this provision evaluates a transferor's solvency both in the present and the future. As to present concerns, a transferor only needs to retain assets sufficient to cover present debts and any debts that are visibly looming. This should do much to assure immediate solvency. As to future concerns, however, the task is not as easy, because it requires forecasting. Fortunately, the problem is lessened — but not eliminated — by UFTA's limited time horizon. Specifically, section 4(b)(9) tests for insolvency "shortly after" a transfer.[248] Although UFTA does not define or explain "shortly after," it seems plausible to conclude that it means something less then the four years allowed as the maximum time for commencing an UFTA action.[249] Despite this uncertainty, proper planning should, in many cases, provide reasonably accurate predictions for a period of up to a year. Such planning would enable the debtor to create reserves that will avoid insolvency "shortly after" a transfer.

The LRSC also negates UFTA section 4(b)(5), which makes it a badge of fraud for a debtor to transfer "substantially all" of his assets.[250] The Commissioners and UFTA do not define this phrase or otherwise explain what is meant by "substantially all." However, the intent of this statutory provision seems clear enough, which is to limit transfers to a level that does not impair the interests of creditors, particularly if the transfer is for less than reasonably equivalent value (REV). This

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[246]UFTA § 4(b)(9), 7A U.L.A. at 653.

[247]*Id.*

[248]*Id.*

[249]UFTA § 9 suggests a four year limitations period and a one year date-of-discovery rule. UFTA § 9, 7A U.L.A. at 665. However, many state legislatures altered § 9 when enacting UFTA, thus making the limitations period the least uniform aspect of the uniform act. *See* 7A U.L.A., Uniform Fraudulent Transfers Act § 9, 7A U.L.A. 217, 261-63 (Supp. 1997).

UFTA § 4(b)(10), which inquires into whether a "transfer occurred shortly before or shortly after a substantial debt was incurred," presents a related issue. UFTA § 4(b)(10), 7A U.L.A. 639, 653 (1984). The passage of time may be a valid defense to later claims that a transfer was made with fraudulent intent.

[250]UFTA § 4(b)(5), 7A U.L.A. 639, 653 (1984).

objective is reflected by the cases cited by the Commissioners in their official comments.[251] The LRSC comports with this objective by restricting transfers to a debtor's surplus over creditor claims. Consequently, in situations where a client's debts equal a large portion of his assets, simple math will prevent the client from parting with "substantially all" of his assets. The LRSC may not yield such restraint in all cases — particularly in those unusual instances when the transferor is virtually free of present and future debt concerns — but, in most cases, the LRSC will prevent transferors from parting with "substantially all" of their assets.[252]

Likewise, the LRSC acts to negate the badges listed in UFTA sections 4(b)(4) and 4(b)(10).[253] Subsection (b)(4) asks whether the debtor was "sued or threatened with suit" before a transfer occurs,[254] while subsection (b)(10) considers whether "the transfer occurred shortly before or shortly after a substantial debt was incurred."[255] In both instances, proper use of the LRSC will protect creditors and create adequate reserves by accounting for any reasonably foreseeable debts that are contemplated in these badges.

The LRSC will not neutralize all of UFTA's badges of fraud. For instance, UFTA section 4(b)(3) tests whether transfers were concealed or disclosed, while section 4(b)(8) asks whether the debtor received reasonably equivalent value in exchange for the transferred assets. The LRSC, and attempts to create adequate reserves, say very little, if anything, about these particular badges. However, "[i]n considering the factors listed in § 4(b) a court should evaluate all the relevant circumstances involving a challenged transfer or obligation. Thus the court may appropriately take into account all indicia negativing fraud as well as those suggesting fraud."[256] Even if the LRSC and the creation of reserves do not directly address the concerns raised by certain badges,

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[251] *Id.* § 4, cmt. 6(e), 7A U.L.A. 639, 655-56 (1984) (citing to Walbrun v. Babbitt, 83 U.S. (16 Wall.) 577 (1872); Lumpkins v. McPhee, 286 P.2d 299 (N.M. 1955); Cole v. Mercantile Trust Co., 30 N.E. 847 (N.Y. 1892)). However, if adequate consideration is paid and the relevant transaction is disclosed rather than concealed, courts will sometimes allow the transfer to stand, even if the transaction was between family members and otherwise left the transferors with no other assets. *See, e.g.*, Schreyer v. Platt, 10 S. Ct. 579 (1890).

[252] If the transferor has only a few creditors with minor claims, it would be easy to reserve for this limited contingency with only a small percentage of the transferor's assets. In this case, the transferor should be free to part with "substantially all" of his assets because only a minor share of his wealth is needed to protect creditors.

[253] UFTA § 4(b)(4), (10), 7A U.L.A. 639, 653 (1984).

[254] *Id.* § 4(b)(4), 7A U.L.A. at 653.

[255] *Id.* § 4(b)(10), 7A U.L.A. at 653.

[256] *Id.* § 4, cmt. 6, 7A U.L.A. at 654-56.

they are nonetheless "indicia negativing fraud" and, at a minimum, will indirectly counter the taint caused by any presence of those badges.

### E. *The Passage of Time*

The passage of time is also a defense to UFTA claims. Consequently, the sooner a planner and client begin transfers, the more likely it is that a plan will withstand later challenge. Naturally, the difficulties associated with projecting future solvency increase as the time horizon lengthens. This means that the LRSC becomes less reliable and the adequacy of the debtor's reserves becomes less clear over time. However, UFTA recognizes this is a factor to consider in evaluating a transferor's intent.[257] This is an implicit recognition that time renders even the best plans uncertain, and carries with it a concomitant implication that UFTA does not expect transferors to act with unearthly clairvoyance.

The timing question is addressed by two of UFTA's statutory badges of fraud. One is section 4(b)(9) and its inquiry into solvency "shortly after" a transfer.[258] Another is section 4(b)(10), which inquires into whether a "transfer occurred shortly before or shortly after a substantial debt was incurred."[259] Taken together, these subsections show that passage of time is a factor to be considered. Stated differently, the more time that elapses between the date of a transfer and the date of a future claim, the more difficult it is to prove the debtor's fraudulent intent at the time of the transfer.

Case law also sanctions the "passage of time" defense. Many of the same cases that support the "reserve" theory as a defense also lend themselves to a "passage of time" analysis, as do other cases.[260] For instance, a Tennessee court recently stated: "[A]s to future creditors the debt must be incurred within a reasonable time after the transfer."[261] Passage of time is also implicitly endorsed as a defense in Pennsylvania's

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[257]UFTA § 4(b)(9)-(10), 7A U.L.A. at 653.

[258]UFTA § 4(b)(9), 7A U.L.A. at 653, addresses whether a "debtor was insolvent or became insolvent shortly after a transfer was made." *Id.*

[259]*Id.* § 4(b)(10), 7A U.L.A. at 653.

[260]*See, e.g.*, Creed v. Lancaster Bank, 1 Ohio St. 1 (1852) (commencing in 1843 to challenge a series of transfers ending in 1829); Phoenix Bank v. Stafford, 89 N.Y. 405 (N.Y. Ct. App. 1882) (reviewing 1870 transfers challenged by persons asserting claims based on 1874 debts). *See also* Higgins v. Johnson, 20 Tex. 389, 396 (1857) ("The debts which are pressing the property were contracted long after the donation to the wife, and cannot set up that the conveyance was in fraud of their rights.").

[261]Hicks v. Sovran Bank/Chattanooga, 812 S.W.2d 296, 301 (Tenn. Ct. App. 1991).

*Leopold v. Tuttle*.[262] The court defined a "future creditor" as someone who asserts claims that are "reasonably foreseen as arising in the immediate future."[263] If enough time passes so that a later creditor's claim arises beyond the parameters of the "immediate future," then he is not a future creditor who is entitled to invoke UFTA's remedies.[264]

The "passage of time" defense is also very rational. There is at best a tenuous or implausible logical connection between a transfer today and claims of fraudulent transfers raised anywhere from two to three years to fifteen years later. For example, if a transferor has paid all previous creditors who presented themselves after a transfer, then subsequent creditors will have a difficult time proving that the transfer was made to "hinder, delay, or defraud creditors" appearing after the transfer.[265] The mere fact that other intervening creditors have been paid refutes a fraud theory and instead implies an intent to honor creditor

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[262]549 A.2d 151 (Pa. Super. Ct. 1988).

[263]*Id.* at 154.

[264]On UFTA being limited to creditors, *see supra* notes 66, 69. *See also* Page v. Corn Exch. Nat'l Bank & Trust Co., 171 A. 560, 562 (Pa. 1934) (explaining that the likelihood of actual future fraud "becomes remote where there is no evidence of . . . any creditors for . . . six or seven years" after a transfer).

In addition to simple passage of time, Peter Spero endorses yet another rule, specifically one that legitimizes fraudulent transfers upon payment or resolution of all pretransfer debts. He states:

> The taint of fraud cannot forever jeopardize the validity of a transfer. Instead, the voidability of a transfer must be limited to a convenient and logical period, namely, the time during which the debts owed by the debtor at the time of the fraudulent transfer remain outstanding. Accordingly, once such pretransfer debts are satisfied or proven to be without merit, the taint is purged. This law is the English rule. United States courts sometimes ignore this rule and allow subsequent creditors to void a transfer regardless of whether there are any preexisting debts still outstanding. "[B]ut that [is] clearly wrong. . . . [O]therwise there would be no protection for any transaction from future attack" and all commercial transactions would be imbued with the uncertainty that they could be set aside by a future creditor of the party that might have engaged in a fraudulent transfer at any time.

SPERO, *supra* note 1, ¶ 3.04[1][a] (footnotes omitted) (alterations in original). Spero's suggestion is not really a "passage of time" analysis, as it can be reduced to the simple rule that the taint of fraud can be purged by an objectively observable event, specifically the retirement of pre-transfer debt, which can occur at any time. Spero's suggestion harkens more to intent questions, as payment of debts existing at the time of transfer implies that the transfer was not intended to defraud existing creditors and, by implication, was also not intended to defraud future creditors, either. *See, e.g.*, Schreyer v. Platt, 10 S. Ct. 579 (1890). In any event, Spero's suggestion harmonizes with at least some existing American precedent, such as Wantulok v. Wantulok, 214 P.2d 477, 482-84 (Wyo. 1950).

[265]UFTA § 4(a)(1), 7A U.L.A. at 652.

claims. The strength of this implication grows with each payment made to a post-transfer creditor.[266]

Similarly, the facts underlying a claim — even one based on a traditional legal theory like negligence — may relate to a new technology or industry that was not even remotely within the transferor's contemplation at the time of transfer. This will make it difficult to prove that a transferor intended to defraud this particular creditor. Although many jurisdictions allow future creditors to proceed on an "all creditors" or "future creditors as a class" theory,[267] the uncontemplated nature of a particular creditor would still reflect a lack of intent. Since the relevant industry or technology was unknown at the time, the transferor could not have intended to defraud anyone associated with that industry or technology. Hence, it may be argued that the transfer was motivated by some other concern. Conceivably, this other motive may have been an improper one, such as an intent to defraud other future creditors who were more foreseeable. Nonetheless, if the claim is an isolated one, which implies that all other intervening creditors were paid, the unforeseen nature of the claim will again negate the fraudulent intent.

Additionally, a claim based on conduct from long ago is apt to cause a plaintiff severe problems with the fact finder, which will compound with each passing month. Assuming *arguendo* that a future creditor suit is allowed under the relevant statute of limitations,[268] the natural sympathy of many jurors or judges will be to leave an ancient transfer undisturbed. The fact finder, whether consciously or unconsciously, may be concerned about the reliance interests that might

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[266]See, e.g., *Schreyer*, 10 S. Ct. at 583, in which the Court approvingly noted that the debtor routinely paid creditors presenting themselves between the time of transfer and the subsequent date on which the creditor's claim arose. *Id.* Similarly, in Winchester v. Charter, 94 Mass. (12 Allen) 606, 609 (1866), the court stated,

> [I]n order to avoid a voluntary conveyance as to subsequent creditors, it would be important to show that it was fraudulent as to existing creditors; otherwise, in the absence of other evidence of intent, it would be difficult to establish a valid ground for the presumption that the transfer was made with a view to hinder and delay subsequent creditors.

*Id.* Further, "The facts . . . [of the case] disclose a case of a voluntary conveyance by a person who was perfectly solvent, *and who subsequently paid in full all the debts which he owed at the time of the grant.*" *Id.* at 610 (emphasis added). Consequently, for these and other reasons, the court reversed a finding against the transferor.

[267]*See supra* note 25.

[268]As noted, UFTA § 9 has a four year limitations period, subject to a date of discovery rule. UFTA § 9, 7A U.L.A. at 665. Hence, a plaintiff who first has reason to investigate the transferor's finances 15 years after a transfer may not have grounds to "reasonably . . . discover[]," § 9(a), the alleged fraud until that late date. *Id.*

have arisen around the transfer in the intervening years.[269] If the allegedly fraudulent transfer involves dispositions into trust, the beneficiaries may have come to rely upon the trust for their subsistence or welfare. For instance, the transferor's children may depend upon the trust to meet their educational or support needs, a spouse may rely upon the trust to pay alimony or medical needs, or some other long standing and innocent equity may have arisen in the intervening years. Judges and juries may tread cautiously when asked by a plaintiff to disturb such intervening interests.[270]

The passage of time also presents a few practical evidentiary problems. Persons with knowledge of the transferor's bad intent — including the transferor himself — may have died or be otherwise unavailable. Those witnesses who remain available may have limited recollections or may not have retained custody of relevant documents. Furthermore, as noted earlier, the passage of time allows a transferor to build a long track record of fulfilling other creditors' needs, thus dispelling any claims of the transferor's intent to defraud.[271]

Creditors' counsel, however, will inevitably think of the superficially correct retort to a passage-of-time defense. The whole point of asset protection planning is to plan for the day when creditors will demand more than the transferor has, thus showing that the planning regime was afflicted with fraudulent intent since its inception.

This retort is too simplistic to be a serious threat to the transfer. It ignores the legal limits on who is a "creditor" under UFTA and forgets that UFTA allows transfers to ward off potential plaintiffs who do not have legally cognizable claims.[272] This creditor analysis also ignores the transferor's intent to remain solvent, as shown by a transferor's good faith adherence to the LRSC, namely through the creation of reserves.

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[269]Arguably, proof of such intervening equities or reliance interests may be irrelevant or otherwise inadmissible due to its propensity to confuse or mislead the jury regarding the key issue of intent. *See* FED. R. EVID. 401-403. However, a desire to benefit these intervening interests could easily prove an altruistic intent to aid the beneficiaries, thus potentially disproving a wrongful intent to hinder, delay, or defraud. Because this alternative purpose may be very relevant to an intent inquiry, such evidence is likely to be admissible in many cases, and certainly has been a factor in at least some reported cases. *See, e.g.*, Higgins v. Johnson, 20 Tex. 389, 395 (Tex. 1857) (finding that when a husband conveys property purchased with community money to his wife, evidence that shows he intended to make a donation to his wife and not a fraudulent transfer against his creditors is deemed pertinent).

[270]*See, e.g.*, Page v. Corn Exchange Nat'l Bank & Trust Co., 171 A. 560, 562 (Pa. 1934) (stating that future creditors who did not bring suit for eight years were "guilty of gross laches" because "[t]he rights of the parties have been very vitally prejudiced by this delay").

[271]*See supra* note 266 and accompanying text.

[272]See *supra* Part III.A.1 for a discussion of the term "claim."

Likewise, the argument overlooks the UFTA's "rule of reason" approach, which requires transferors to consider only reasonably foreseeable debts, and not debts that are unexpected either in terms of their nature or extent.[273] The claims of a "remotely subsequent creditor," which include those creditors who are remote in both likelihood and time, are simply not protected.[274] For these reasons, such creditor arguments should be rejected.

### F. *The Role of Disclosure: Future Creditors with Notice Have No Basis to Complain*

Courts have often denied relief to future creditors who knew of a past transfer but who still voluntarily extended credit despite knowledge of that transfer.[275] The basic theory behind these decisions is that such creditors did not care about the prior transfer and instead extended credit based on the security or comfort provided by other property retained by the debtor.[276] If a creditor has notice of transfers and still extends credit,

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[273]See *supra* Part III.B.5.a for a discussion of the "rule of reason."

[274]See, e.g., Schreyer v. Platt, 10 S. Ct. 579, 581 (1890) (refusing to uphold the claim "especially . . . [of] such a remotely subsequent creditor"). As a technical matter, creditors who are remote in terms of likelihood are protected, but only to the extent of the discounted risk they present. *See supra* note 195. As a result, a very low probability creditor would be afforded virtually no protection.

[275]See, e.g., Hicks v. Sovran Bank/Chattanooga, 812 S.W.2d 296, 301-02 (Tenn. Ct. App. 1991), in which an undersecured bank was denied relief on a fraudulent conveyances claim designed to enable collection of an amount sufficient to cover the bank's uncollected deficiency. The total debt was $50,000, the secured amount was $40,000, and the resulting deficiency (exclusive of interest) was $10,000. *Id.* at 302. The debtor had transferred most of his assets to his wife. *Id.* at 301. The bank knew of these transfers but nonetheless allowed subsequent disbursements on a line of credit, thereby allowing the total debt to exceed $40,000 and to eventually rise to $50,000. *Id.* at 301-02. The court refused to unravel the interspousal transfers, saying in pertinent part:

> [W]e nevertheless find there is evidence to support the jury verdict that Mr. Hicks did not intend to defraud the Bank. We reach this conclusion because the proof shows that the Bank knew Mr. Hicks had transferred the majority of his assets to his wife . . . .
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> . . . .
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> Moreover, case law dictates that transfers may not be set aside unless prejudice results to the party seeking relief. In light of our foregoing determination the Bank obviously has not been prejudiced as to $40,000 of its indebtedness, and it is arguable that the Bank has not been prejudiced as to the balance, because it had full knowledge of the transfers and could have protected itself...

*Id.* (citation omitted).

[276]See, e.g., Schofield v. Cleveland Trust Co., 21 N.E.2d 119, 122 (Ohio 1939) ("[F]uture creditors give credit to their debtor on the basis of what he has, and not on the basis

he must not have then considered the prior transfer harmful to his interests. Such a creditor cannot complain after the fact. This rule has been aptly summarized by one reference treatise as follows:

> A conveyance may not be attacked by a subsequent creditor who, at the time he extended credit to the transferor, had actual or constructive notice of a prior conveyance made with fraudulent intent. In other words, creditors who have extended credit under such circumstances that knowledge of previous voluntary transfers must be imputed to them cannot be regarded as hindered, delayed, or defrauded by such transfers, and therefore, they may not attack such conveyances for the purpose of obtaining collection of their debts.[277]

This rule is significant for various reasons. First and foremost, if proper notice is given, the rule should be a legal bar that works to eliminate, or at least substantially reduce, the opportunities for creditors to complain. Second, this rule comports with UFTA. One of the most crucial badges of fraud is whether a transfer was disclosed or concealed.[278] Clients who follow the disclosure rule will also obviate this

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of what he once had."). Note, however, that at least part of *Schofield* has been overridden by statute. *Schofield* stated that the only basis for a future creditor claim was actual fraud. *Id.* at 121. UFTA, which has been adopted by Ohio, OHIO REV. CODE ANN. § 1336.01 (Anderson 1993), expressly allows claims of constructive future fraud. UFTA § 4(a)(2), 7A U.L.A. at 653.

[277]37 AM. JUR. 2D *Fraudulent Conveyances* § 144 (1968) (noting that recorded prior conveyances provided "constructive notice" that was "sufficient" for subsequent creditors); Rose v. Morrell, 259 A.2d 8, 11 (Vt. 1969) ("[p]laintiffs, as subsequent creditors with notice . . ., are in no position to complain that they were hindered, delayed or defrauded"). For a similar statement of the rule, as well as additional case citations, see 37 C.J.S. *Fraudulent Conveyances* § 139 (1943), which states:

> [T]he general rule is that a conveyance cannot be attacked on the ground of fraud by a creditor whose claim was acquired after due notice, either actual or constructive, of such conveyance, in the absence of some fraudulent device practiced on a subsequent creditor and participated in by the grantee, the effect of which is to cause the creditor not to examine the record. . . . [I]t has also been held that, even though a grantor may have intended to defraud subsequent creditors by conveying his property, he frustrated that intent by placing the conveyance of record.

*Id.*

[278]UFTA § 4(b)(3), 7A U.L.A. at 653 (testing "whether the transfer or obligation was disclosed or concealed"). *See also* Walton v. First Nat'l Bank, 22 P. 440, 444 (Colo. 1889) (holding that concealment is "one of the strongest badges of fraud").

particularly important badge as a matter of law.[279] Third, as litigators would quickly note, disclosure has a practical significance over and above any legal significance. Many jurors will automatically conclude that there is something wrongful about undisclosed transactions, even if the relevant transaction was entirely proper. Disclosure minimizes the risk of this type of visceral layman's reaction because the transferor can honestly testify that he made his transactions available for the whole world to see. This testimony will often appease a jury, or, at the very least, minimize the risk of antagonizing a jury. Either way, it does much to improve the odds that a transfer will be viewed as nonfraudulent. Fourth, disclosure can be easily accomplished. For instance, any transfers or encumbrances of real estate should be recorded pursuant to local recording laws, thereby generating constructive notice.[280] Similarly, if any personal property is encumbered, financing statements should be filed pursuant to the local version Article 9 of the U.C.C.[281] If a foreign trust is used, proper tax reporting returns should be filed with the Internal Revenue Service.[282]

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[279]Some old pre-UFTA cases occasionally stated that notice would not cut off the rights of future creditors. Such statements were usually associated with the view that fraud as to any creditor, including present creditors, was fraud as to all creditors, including future creditors. *See, e.g.*, Williams v. Banks, 11 Md. 198, 245-47 (1857) (Eccleston, J., speaking for himself, stated: "What follows . . . only expresses the views of the judge by whom this opinion is written."). Under the "all creditors" theory, "notice of the conveyance to a subsequent creditor, will not prevent him from coming in, because when once the deed has been set aside as fraudulent, so far as creditors are concerned, it is as though it never existed, consequently notice to the creditor can make no difference." *Williams*, 11 Md. at 246. However, this view was sharply criticized even before UFTA, especially in the context of real estate transactions that were recorded and available for inspection and review by the whole world, particularly future creditors. *Id.* at 249-51 (referring to the opinion of Chief Justice LeGrand and Justice Tuck). Apart from the logical problems associated with letting creditors unravel transactions that they knew about before extending credit, the early critics also noted that the opinions giving such rights to future creditors predated the enactment of recording statutes that enabled public review of real property titles. *Id.* Hence, the recording statutes obviated the need to confer such broad rights on future creditors, as they were able to protect themselves. Moreover, the same logic that applies to notice regarding real estate also applies to any other asset. Creditors who know that a debtor does not have title to certain assets can hardly be said to have reasonably relied on such assets, and "[i]t seems . . . to be a contradiction in terms to say, that a person is defrauded by an instrument when he deals with a perfect knowledge of its existence and of its effect." *Id.* at 250. Finally, since UFTA is a later statute that expressly considers the presence or absence of disclosure, any vestigial remnant of the old view that notice was inconsequential should be regarded as legislatively overridden.

[280]Columbia Gas Transmission Corp. v. Bennett, 594 N.E.2d 1, 5 (Ohio Ct. App. 1990) (noting that one who purchases real property is effectively charged with constructive notice of all prior conveyances recorded in the chain of title).

[281]U.C.C. §§ 9-301 to -304, 9-401 (1995) (detailing when financing statements are needed to perfect security interests).

[282]26 U.S.C. § 6048 (1994). Enacted in late 1996 and effective in 1997, this section

Clients should make sure that dealings conducted through entities, such as a family limited liability company, are clearly designated as an entity business and not individual or personal transactions.[283]

As a corollary to disclosure, the client must also understand that there are certain representations that he cannot make. Specifically, transferred assets can no longer be included in the client's balance sheet. For instance, if funds or property are transferred to a limited partnership, the client no longer owns those items and they cannot be counted among his assets. Instead, the client now only owns an interest in the entity, which can be listed, although it usually has less value than the underlying assets.[284] Similarly, if assets have been placed in a foreign APT[285] or in exempt property, the transferor's beneficial interest in the trust (if any) and the exempt assets should be omitted. Alternatively, if these interests are included, the application should be footnoted or otherwise supplemented to indicate the unavailability of these assets to creditors. These corollary practices will also help to avoid later claims that the client was engaged in a scheme to defraud and may actually defeat the intent element of actual fraud.

Thus, disclosure and related steps are significant. A client who practices disclosure will avoid the appearance that he may be trying to improperly hide assets. This, in turn, greatly enhances the odds that his

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substantially increased reporting requirements for transfers to foreign trustees.

[283]Of course, this "corporate veil" theory will not insulate a person for their own individual acts or omissions, even if they are conducted on behalf of a corporation. *See, e.g.*, Galie v. RAM Assocs. Management Servs., Inc., 757 P.2d 176, 177 (Colo. Ct. App. 1988) (finding that "an agent may be held personally liable for torts committed by him including his own misrepresentations, even though the tortious acts were done on behalf of his principal").

[284]Indeed, even the I.R.S. has recognized that this decline in value occurs. *See* Rev. Rul. 93-12, 1993-1 C.B. 202. This is due to two factors: the "marketability discount" and the "minority discount." The marketability discount reflects the fact that there is usually no ready market for most limited partnership interests. This lack of a market is a practical matter (i.e., no stock exchange or other quick way to liquidate). Such interests are also frequently made even more illiquid by agreements subjecting all transfers to the approval of the remaining interest holders. The minority discount arises from the fractionalization of interests. This discount factor, in turn, has its own two subparts. The first subpart reflects the fact that a majority owner has lost his unrestricted right to use property because he is obligated (to varying degrees) to protect the interests of minority owners. Subpart two indicates that minority owners, even in the best of circumstances, can be outvoted and thereby lose a substantial degree of control. Hence, fractionalizing ownership impedes the rights of both the minority and majority interests. These theories are reflected in the cases cited by the I.R.S. in Rev. Rul. 93-12, and also in other cases, such as True v. United States, 547 F. Supp. 201, 203 (D. Wyo. 1982) (holding that restrictive provisions in a partnership agreement must be considered as a factor in the valuation, since it usually decreases the share value).

[285]*See supra* note 163 and accompanying text.

protective structure will be deemed valid and that future creditors will have no grounds for complaint.

## IV. EXCEPTIONS TO SECTION 4(a)(1) REGARDING PRESENT AND FUTURE CREDITORS

In addition to the issues discussed above that are uniquely related to actual future fraud, there are at least two issues relevant to actual fraud as to both present and future creditors. The first is the existence of definitional limits on the word "transfer," and the other is UFTA's "no harm, no foul" approach, which basically absolves solvent people of transfers tainted with fraudulent intent.

### A. *Not Every Transfer is a UFTA "Transfer"*

"Transfer" is a defined term under UFTA, and "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."[286] This definition is, indeed, broad. However, as with "claim," the term has limits and, as a result, not every transaction involving the debtor's property is a "transfer" under UFTA. Further, if a transfer does not occur, then, *a fortiori*, a fraudulent transfer cannot exist.

The leading case for this proposition is *In re* Levine,[287] in which a debtor burdened with substantial debts converted approximately $440,000 of nonexempt property into exempt form in order to prevent attachment of those assets.[288] The court ruled that this was perfectly acceptable and reasoned that a fraudulent transfer cannot exist unless there is a transfer involving a transferor and a transferee.[289] Thus, if a debtor does not transfer assets to another person, but merely converts the form of his own assets, there has not been a transfer, so the fraudulent transfer laws do not apply.[290]

*Levine*'s rationale is controversial. The permissibility of converting nonexempt assets to an exempt form is notoriously ambiguous and murky, but such conversions are sometimes held to be fraudulent

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[286]UFTA § 1(12), 7A U.L.A. at 645.
[287]139 B.R. 551 (Bankr. M.D. Fla. 1992).
[288]*Id.* at 552.
[289]*Id.* at 553.
[290]*Id.*

transfers, especially if a conversion is made on the eve of bankruptcy[291] or with a particular creditor in mind.[292] Indeed, at least two states with generous exemption regimes — Florida and Texas — have statutorily decreed that converting property with the intent to hinder creditors is fraudulent, thereby causing the property to lose its exempt character.[293] Moreover, a mechanistic view of a conversion procedure can be used to show that the debtor who converts property is, in fact, making a transfer. The debtor has parted with a nonexempt asset, such as cash, and has exchanged it for an asset that is exempt under applicable state law, such as cash value insurance or annuities. In view of UFTA's broad definition of "transfer,"[294] this could reasonably be perceived as a transfer of property and, specifically, of cash. However, courts do not always favor mechanistic views, and *Levine* is, therefore, an argument that a planner might rely upon to justify a conversion of nonexempt property to an exempt form. If counsel persuades the court that a conversion is not a transfer, then creditors cannot invoke laws against fraudulent transfers.

A *Levine* argument is especially appealing in connection with conversions made before a "claim" arises, such as, in cases involving allegations of actual future fraud. Pre-"claim" conversions can be seen as part of a debtor's normal course of business planning. Stated differently, such conversions are not tainted by improper intent.[295] This

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[291]*See, e.g.*, Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871, 876-77 (8th Cir. 1988) (holding that the physician debtor's liquidation of nearly $700,000 and conversion to exempt property on the "eve of the bankruptcy" was an intent to defraud creditors and resulted in a denial of discharge under 11 U.S.C. § 727 (1994)).

[292]*In re* Oberst, 91 B.R. 97 (Bankr. C.D. Cal. 1988). However, there is a "grey area between 'bankruptcy planning' and 'intent to hinder, delay, or defraud a creditor.'" *Id.* at 99. It can be "very difficult to locate the exact line between bankruptcy planning and hindering creditors." *Id.* at 101. Further, a debtor may convert one exempt asset into another because the property in question was already beyond creditor reach, thereby causing no loss to creditors upon conversion. *In re* Kimmel, 131 B.R. 223, 229 (Bankr. S.D. Fla. 1991).

[293]FLA. STAT. ANN. § 222.30 (West 1989), and TEX. PROP. CODE ANN. § 42.004(a) (West 1997), both of which prohibit conversions made with intent to hinder, delay, or defraud creditors. However, despite these statutes, conversion of nonexempt assets to exempt homestead form is permissible in Florida. The Florida homestead exemption is a right conferred by the Florida constitution and cannot be overridden by statute, thereby entitling Florida debtors to convert. *In re* Clements, 194 B.R. 923, 925 (Bankr. M.D. Fla. 1996). Because the Texas homestead is also protected by its state constitution, TEX. CONST. art. 16, §§ 50-51, a similar result might accrue in Texas.

[294]UFTA § 1(12), 7A U.L.A. at 645.

[295]At least one state — Texas — expressly recognizes a "normal business" argument as part of its statutory law. TEX. PROP. CODE ANN. § 42.004 (West 1997) states: "It is a defense to a claim under this section that the transfer was made in the ordinary course of business by the person making the transfer." *Id.* § 42.004(c). There is no reason that a debtor in other states cannot make a similar argument based on policy or the facts of a particular case

additional factor may incline a court to be more receptive to a *Levine* argument. This is not necessarily logical, because the argument is actually not about the definition of "transfer." Rather, it is a debate concerning "intent." However, this is a practical concern, because courts are apt to be more sympathetic to transfers made with good intent as opposed to bad. A *Levine* argument, therefore, may have greater impact in courts that are presented with other evidence of good intent.

At least one other bankruptcy case gives additional insight into the term "transfer." In *In re Messia*,[296] the debtor was involved in a car wreck.[297] Approximately ten days later, she filed a declaration of homestead pursuant to Massachusetts law, the effect of which was to purportedly exempt the entire value of her $135,000 home from attachment and foreclosure.[298] The bankruptcy trustee challenged the declaration on the grounds that it was a fraudulent transfer.[299] The bankruptcy court ruled that a fraudulent transfer did not occur because filing the declaration of homestead was not a transfer.[300] In reaching its conclusion, the court analyzed the statutory definition of "transfer" and stated:

> Inherent in the quoted definitions is a requirement that a "transfer" include the acquisition of an interest by a third party. The emphasis is upon "disposing of or parting with" interests in property, which events do not occur when a homestead is declared. There is no third party involved in a declaration of homestead.[301]

*Messia* is important in at least two respects. First, it is arguable support for *Levine*. After all, the crux of *Levine* was that a third party was not involved, since the debtor did not give up property, but merely

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and, indeed, courts are sometimes receptive to such arguments. *See, e.g.*, *In re* Kimmel, 131 B.R. 223, 229 (Bankr. S.D. Fla. 1991) (finding that "[w]hether a particular transfer is made to the end, purpose or intent to delay, hinder, or defraud a creditor is to be determined by the facts and circumstances of each case").

[296]184 B.R. 176 (Bankr. D. Mass. 1995).

[297]*Id.* The holder of an unliquidated tort claim, such as an auto accident victim, is a "creditor" under UFTA the moment the accident occurs. *See, e.g.*, *In re* Olivier, 819 F.2d 550, 552-53 (5th Cir. 1987) (construing Bankruptcy Code provisions dealing with fraudulent transfer issues).

[298]*In re Messia*, 184 B.R. at 176-77.

[299]*Id.* at 177.

[300]*Id.*

[301]*Id.* Note also that the Bankruptcy Code and UFTA use very similar definitions of "transfer." 11 U.S.C. § 101(54) (1995); UFTA § 1(12), 7A U.L.A. at 645.

changed its form. This rationale is also apparent in *Messia*, which expressly stated that a "transfer" must "include the acquisition of an interest by a third party."[302] Admittedly, *Messia* and *Levine* entail very different mechanics. To illustrate, unlike the debtor in *Levine*, who undoubtedly conveyed his nonexempt assets in exchange for exempt property, the debtor in *Messia* did not exchange assets to generate her exemption. Instead, she merely filed a piece of paper that unilaterally declared the exempt nature of her homestead.[303] This filing did not transfer title to a third party, and the property was consistently in her name. Still, a transferor can cite *Messia* and *Levine* together for the broad proposition that transactions are not "transfers" unless they entail a net conveyance of assets to a third person.

Second, and more plausibly, *Messia* supports the view that a fraudulent transfer does not occur when a debtor moves himself or his property to another jurisdiction, provided title is not transferred. This conclusion is not the direct holding of *Messia*, but it is a necessary implication of the case.

To appreciate the significance of this second point, it is first necessary to understand the wide divergence in state law classifications of exempt property. Some states offer only limited exemptions, while others offer very broad exemptions. For instance, while an Ohio resident will have only minimal protection for his wages, a Florida resident who qualifies as a "head of family" may totally exempt his income from creditor claims.[304] Consequently, debtors' counsel will often try to ward off attachments and executions by advising a client to establish residency in a debtor-friendly state and to move her property to her new home. Creditors' attorneys sometimes complain that such moves themselves are fraudulent transfers. However, there are potentially serious constitutional infirmities with this argument, as persons afflicted with economic hardship possess a right to travel from state to state in order to seek out

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[302] *In re Messia*, 184 B.R. at 177.

[303] *Id.* at 176-77.

[304] FLA. STAT. ANN. § 222.11(2)(a) (West Supp. 1996) flatly prohibits attachment or garnishment of the first $500 a week in "disposable earnings" attributable to a "head of family," while § 222.11(2)(b) allows attachment or garnishment of amounts over $500 a week only if the head of family consents in writing. FLA. STAT. ANN. § 222.11(2)(b) (West Supp. 1996). This means that a head of family can potentially exempt his entire income. *See also* Attorney Gen. of N.Y. v. Soto-Lopez, 476 U.S. 898, 901-02 (1986) (noting that "freedom to travel throughout the United States has long been recognized as a basic right under the Constitution" and "includes the freedom to enter and abide in any State in the Union") (interior quotes and citations omitted).

better opportunities.[305] Further, under *Messia*, these moves are not even transfers, much less fraudulent transfers, provided that the debtor keeps the property in her own name and does not convey title to a third person. Thus, a peripatetic or mobile debtor with a lucrative consulting contract may find it advantageous to move to a state like Florida, which provides broad wage and income protection. This relocation would create a strong argument that this income-generating contract is exempt from creditor claims. At best, this tactic will succeed in stopping a creditor. At worst, this approach will buy time, which in itself can be valuable. This tactic may also create an argument so plausible that a creditor will offer far more palatable compromises.

Consequently, by simply moving, and without transferring title to another person, the debtor should be able to invoke the exemption laws of her new state and protect additional assets from creditor assault. Moreover, a debtor can move herself and her assets in contemplation of present or future creditors. Thus, *Messia* and *Levine* are useful to planners and clients even if their only concern is the future.

*Messia* also legitimizes the time-honored tactic of simply moving assets. Sound planning often entails moving a client's assets out of his home jurisdiction to another venue, while continuously maintaining title in the client's name. Such moves are often made well in advance of any claim or judgment, and a debtor can move assets to another jurisdiction within the United States or into foreign countries. Such pre-claim movement of assets has potentially profound tactical value simply because a financial diaspora can make life very difficult for creditors seeking collection and can buy valuable time, which, as previously noted, can be a great aid in settlement negotiations. Additionally, since title is always in the debtor's name, no "transfer" is involved. Thus, UFTA and its ban against hindering and delaying creditors does not apply.

Generally, there is nothing to prevent a client from keeping assets outside his state of residence. For example, if a Wyoming client is concerned about possible future claims, he may choose to keep his bank account elsewhere, such as Montana. If a future judgment arises in a Wyoming court, or if an out-of-state judgment (say from Massachusetts) is transferred to the debtor's home state, the judgment creditor can invoke the collection procedures of the Wyoming courts to levy and execute

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[305]Edwards v. California, 314 U.S. 160, 173 (1941) (invoking the Commerce Clause to strike down a statute barring Californians from assisting "indigent" persons entering into the state); *id.* at 181 (Douglas, J., concurring) (invoking the Privileges and Immunities Clause and stating that, as an incident of national citizenship, "mobility . . . is basic to any guarantee of freedom of opportunity").

upon those bank accounts. However, because the client has previously moved his bank accounts to Montana, the Wyoming collection process will initially be useless to the creditor. There will be no cash in Wyoming for the Wyoming courts to garnish,[306] and the judgment cannot immediately be enforced in Montana, because it has not yet been entered in the Montana court system.

For several reasons, though, moving assets in this fashion may be only a temporary expedient. First, under both the Full Faith and Credit Clause[307] and the Uniform Enforcement of Foreign Judgments Act[308] which is in effect in most states,[309] a creditor can transfer judgments from one state to another. Applied to the hypothetical above, the Wyoming judgment can be transferred to Montana, allowing the judgment creditor to invoke Montana's local collection procedures. Unfortunately for the creditor, by the time he finds the money in Montana, transfers the judgment, and begins collections procedures, the debtor may have moved the cash to a third state. This forces the creditor to incur the time and expense of repeating the process. This ordeal may cause some creditors to give up the hunt, but the aggressive creditor may eventually catch his prey. Therefore, moving assets is not an ironclad way to shelter them.

The creditor may also benefit from a grant of injunctive relief that orders a debtor to freeze assets or otherwise turn over property to the creditor. If this occurs, then the debtor must comply or face contempt sanctions, which could include serving time in jail.[310] Many creditors refrain from seeking such extreme relief, and courts may be reluctant to enter meaningful contempt sanctions in a civil collections matter, particularly if the case does not involve claims for child support or alimony. However, if a debtor is subjected to a contempt order with harsh sanctions for noncompliance, then the tactical value of simply moving assets will be lost. Consequently, just moving the assets is not enough. A debtor may wish to seriously consider moving himself, as

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[306]The sheriff of each county in the state of Wyoming is authorized to attach and keep any property belonging to the debtor found within the sheriff's jurisdiction. WYO. STAT. ANN. § 1-15-202(d) (Michie 1997). However, property that has been moved to another state is clearly outside of the sheriff's reach.

[307]U.S. CONST. art. IV, § 1.

[308]13 U.L.A. 149 (1986).

[309]*See* Uniform Enforcement of Foreign Judgments Act, 7A U.L.A. 13, 13-14 (Supp. 1997) (listing 44 states, the District of Columbia, and the Virgin Islands as having adopted the act).

[310]*See, e.g.*, International Union, UMWA v. Bagwell, 512 U.S. 821, 828 (1994) (noting that imprisonment for a fixed term, with the option of early release for compliance, is an effective civil contempt sanction because it often coerces the contemnor into obeying the court's order).

well as his property, to a debtor-friendly state.[311] This tactic not only slows down the creditor, but ensures that when he finally catches up with the debtor, the subsequent litigation will take place in a more debtor-friendly court.

Despite the limitations illustrated above, *Messia* remains significant because it demonstrates that a debtor may move assets without violating UFTA, provided the assets remain in the debtor's name.

### B. *No Harm, No Foul: Solvent People May Make Fraudulent Transfers*

Somewhat amazingly, UFTA virtually invites solvent people to make fraudulent transfers, as evidenced in the definition of "insolvency" in section 2 and the role of insolvency as a badge of fraud. Taken together, these provisions are nothing less than an application of the proverbial "no harm, no foul" rule.

UFTA sections 2(a) and 2(b) recognize two very basic types of insolvency: balance sheet insolvency and cash flow insolvency.[312] In addition, section 2(d) also states that fraudulently transferred property is to be excluded from the transferor's asset base when testing for solvency.[313] Taken together, these sections implicitly recognize the possibility that a person may fraudulently transfer away certain assets yet still remain solvent. If, after the conveyance, the transferor is still paying debts when they come due, then there is no presumption of insolvency based on cash flow.[314] Likewise, if the debtor's post-conveyance balance sheet still yields a positive net worth, then there is also no balance sheet

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[311]State law exemptions are frequently limited to residents of a state. *See generally* 35 C.J.S. *Exemptions* § 2 (1997) (noting that exemption laws will generally not be enforced by the courts in other states, but if an exemption statute does not expressly require residence, then the courts disagree as to whether the statute applies only to residents). Therefore, to fully avail himself of state debtor protection laws, it is usually better for the debtor to move himself as well as his property to a debtor-friendly venue.

[312]Balance sheet insolvency is recognized by UFTA § 2(a), which states, "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." UFTA § 2(a), 7A U.L.A. at 648. UFTA § 2(b) recognizes cash flow insolvency by establishing the following presumption: "A debtor who is generally not paying his [or her] debts as they become due is presumed to be insolvent." *Id.* § 2(b), 7A U.L.A. at 648 (brackets in original). In addition to balance sheet and cash flow insolvency, UFTA § 4(a)(2)(i) also recognizes that transfers may leave a debtor too thinly capitalized. *Id.* § 4(a)(2)(i), 7A U.L.A. at 653. This is, in effect, a variant of cash flow insolvency: The thin capital may not yet have resulted in an inability to pay debts but has certainly raised the spectre of such shortfalls.

[313]UFTA § 2(d), 7A U.L.A. at 648.

[314]*Id.* § 2(b), 7A U.L.A. at 648.

insolvency.[315] At the same time, UFTA section 4(b)(9) notes that insolvency in the wake of a transfer is a badge of fraud.[316] However, if the transferor's post-conveyance finances are devoid of insolvency, then this particular badge of fraud is neutralized. Further, if a debtor pays his post-transfer bills in a timely fashion, it is doubtful that any other badge of fraud would manifest itself. Thus, UFTA allows transfers designed to hinder, delay, and defraud provided that the debtor remains solvent. This comports with UFTA's theory of protecting unsecured and undersecured creditors.[317] If the debtor pays his bills and covers his liabilities, then the debtor has not injured his creditors, and the protected class does not need relief.

As shown above in connection with the LRSC and "reserve" theory, transferors who intentionally retain post-transfer solvency are probably devoid of the fraudulent intent needed to sustain a claim of actual fraud. However, not all transferors act with such foresight, and some may make poorly considered transfers that are laden with ill intent. Their continued solvency may be the result of chance, miscalculation of a balance sheet, or a misunderstanding of how readily creditors can attach unconveyed assets. Regardless of the reason, this does not remove the bad intent that afflicted the transfers in question. However, even such tainted conveyances are not necessarily actionable under UFTA. If, despite his malicious intent, a debtor fails to injure his creditors, then the transfer in question can be left undisturbed.

The "no harm, no foul" rule is potentially very important for planners, who are often asked to review a client's portfolio after the client has made transfers without the advice of counsel. A client's untutored conduct will frequently cause planners to address difficult questions as to which prior transfers, if any, should be reversed. If other assets are still available to satisfy legitimate demands, then the planner can leave tainted transfers in place, thus saving considerable time and expense (including the time and expense of arguing with the client). The planner will also avoid the embarrassment and the difficult questions that may be raised by sudden reversals of transfers.

Additionally, once a client obtains proper counsel, the client can commence building a structure that intentionally creates reserves for legitimate claims. This sudden change could obviate the transferor's prior ill intent. The planner does not need to reverse the earlier conveyances where assets were fraudulently transferred. Instead, he can

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[315] *Id.* § 2(a), 7A U.L.A. at 648.
[316] *Id.* § 4(b)(9), 7A U.L.A. at 653.
[317] UFTA § 1, cmt. 3, 7A U.L.A. at 646; *id.* § 3, cmt. 2, 7A U.L.A. at 650-51.

reposition those assets in proper shelters that are far more likely to withstand later challenge than the client's prior efforts. For instance, once a proper reserve is established for legitimate creditors, other assets that had been wrongfully "parked" in a spouse's name can then be placed in a trust, a holding company, a protected pension plan, or any one of a number of lawful shelters. The "no harm, no foul" rule can be extremely significant to planners who must help clients fix the problems that the clients created when acting without counsel.

## V. NOT EVERY FRAUDULENT TRANSFER STAYS FRAUDULENT AND THE ULTIMATE FALLBACK OF BANKRUPTCY IS USUALLY AVAILABLE

As a last resort, many debtors turn to the bankruptcy courts for relief. This right is still available for most planning clients. Under prevailing bankruptcy law in most circuits, a client can still obtain a bankruptcy discharge even if he has made a fraudulent transfer. At first blush, this result is quite surprising. Title 11, section 727 of the United States Code appears to bar a Chapter 7 discharge for anybody who has made a fraudulent transfer within one year of filing for bankruptcy, and Chapters 11 and 13 would seem to bar discharges because fraudulent transfers seemingly violate the necessary "good faith" requirement.[318] However, many courts disagree. Once again, the analysis turns around the word "transfer." The majority view holds that a fraudulent transfer is not really a transfer unless the relevant property stays transferred. Therefore, if a debtor voluntarily unravelled a transfer before certain events unfold in a bankruptcy, the transfer does not count and the transaction is not fraudulent.

The leading case in this area is *In re* Adeeb.[319] Mr. Adeeb was proprietor of a troubled business plagued by creditor demands, and he turned to a nonbankruptcy attorney for advice.[320] This attorney advised

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[318]Section 727 applies only in Chapter 7 liquidation cases. 11 U.S.C. § 103(a) (1994). Chapters 11 and 13 require that a plan be put forth in "good faith." 11 U.S.C. §§ 1129(a)(3), 1325(a)(3) (1994). Fraudulent transfers can be grounds for finding bad faith. Duttle v. Bandler & Kass, No. 82 Civ. 5084, 1992 WL 162636, at *6 n.2 (S.D.N.Y. June 23, 1992). Additional bars to discharge in Chapter 13 are set forth in 11 U.S.C. § 1328 (1994). Further, a Chapter 13 discharge may be revoked on grounds of fraud. 11 U.S.C. § 1328(e) (1994). Presumably, undisclosed fraudulent transfers amount to fraud due to false statements in the debtor's petition. Likewise, a Chapter 11 discharge may be revoked on grounds of fraud. 11 U.S.C. § 1144 (1994).

[319]787 F.2d 1339 (9th Cir. 1986).

[320]*Id.* at 1341.

Adeeb to take assets out of his own name and to place legal title in the name of trusted friends.[321] Adeeb did so, and retained the beneficial interest in these assets after the transfers.[322] Adeeb's finances continued to deteriorate, however, and Adeeb then sought counsel from a bankruptcy attorney.[323] This second attorney told Adeeb to unravel the transfers, and Adeeb commenced efforts to voluntarily undo his prior conveyances.[324] Adeeb also contacted his creditors and voluntarily disclosed both the transfers and the fact that he was in the process of reversing those transfers.[325] Shortly thereafter, and before all transfers were reversed, several of the creditors filed an involuntary bankruptcy petition against Adeeb.[326] Mr. Adeeb did not challenge the involuntary petition, but instead acquiesced and filed his own subsequent voluntary petition.[327] At all times, Adeeb continued the voluntary unravelling process.[328] Despite this, the trustee and various creditors challenged Adeeb's right to a discharge, arguing that section 727[329] mandated a denial of discharge, since the debtor's fraudulent transfers occurred within one year of filing.[330] In response, the debtor contended that he was entitled to a discharge despite his fraudulent transfers because he had voluntarily disclosed the transfers and was also voluntarily unravelling them.[331] Both the bankruptcy court and the district court rejected Adeeb's arguments, however, and Adeeb was denied his discharge.[332]

On appeal, the Ninth Circuit agreed with Adeeb and reversed the lower courts.[333] The court first concluded that the word "transferred"

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[321] *Id.*

[322] *Id.*

[323] *In re Adeeb*, 787 F.2d at 1341.

[324] *Id.*

[325] *Id.* at 1341-42.

[326] *Id.* at 1342.

[327] *In re Adeeb*, 787 F.2d at 1342.

[328] *Id.*

[329] 11 U.S.C. § 727(a)(2)(A) (1995) states,

> (a) The court shall grant the debtor a discharge, unless . . . (2) the 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 . . . .

*Id.*

[330] *In re Adeeb*, 787 F.2d at 1342.

[331] *Id.* at 1343.

[332] *Id.* at 1342.

[333] *Id.* at 1346.

means "transferred and remained transferred."[334] Consequently, attempted fraudulent transfers may not even amount to "transfers," much less fraudulent acts, if the transaction comes undone.[335] The court established a three-prong test for determining whether a debtor is entitled to a discharge despite attempted fraudulent transfers.[336] Specifically, to obtain a discharge, a debtor must:

1. Disclose the transfers to his creditors;
2. Recover "substantially all" of the property before filing for bankruptcy relief; and,
3. Be otherwise entitled to a discharge.[337]

Significantly, the language used by the court to establish this three-prong test was cast in general terms. The court did not limit this portion of its holding to involuntary petitions, but instead used language that is equally applicable to voluntary petitions. In other words, debtors may seek refuge in bankruptcy court, despite their prior mistakes, provided they take steps to rectify the situation before filing.

In reaching these legal conclusions, the court relied on statutory interpretation, by noting that the language of section 727:

> demonstrates that Congress intended to deny discharge to debtors who take actions designed to keep their assets from their creditors either by hiding the assets until after they obtain their discharge in bankruptcy or by destroying them. . . . The only type of transfer that has the effect of keeping assets from creditors is a transfer in which the property remains transferred at the time the bankruptcy petition is filed.[338]

Based on this reading of the Bankruptcy Code, the grounds for denying discharge are absent if the relevant property is made available to creditors. The court, relying on policy grounds, noted that the two paramount goals of the Bankruptcy Code are to give an honest debtor a fresh start and to maximize the equitable distribution of estate assets to

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[334] *In re Adeeb*, 787 F.2d at 1344-45.
[335] *Id.* at 1345.
[336] *Id.*
[337] *Id.*
[338] *In re Adeeb*, 787 F.2d at 1345.

creditors.[339] The court concluded that its interpretation of "transfer" fostered those objectives by rewarding debtors who return assets to the estate, thus encouraging honesty while also protecting creditors by maximizing assets available for distribution.[340] Accordingly, the court reversed and remanded for a determination of whether Adeeb had satisfied the newly established three-prong test.[341]

*Adeeb*, however, leaves open some interesting questions. For instance, what measure of disclosure is needed to satisfy the first of *Adeeb's* three prongs? Likewise, what is meant by "substantially all" in connection with *Adeeb*'s second prong? These issues are certainly ripe for litigation, and an adverse decision could prevent a discharge for an asset protection client whose planning failed to the point that bankruptcy was necessary.

There is also an element of voluntariness implicit in both of *Adeeb's* first two prongs. For instance, a debtor who is forced into disclosure and an unravelling of transfers by a state court's contempt orders may be deemed to have failed those first two prongs, since his acts are more the doing of the court and the creditors than his own. *Adeeb's* facts lend themselves to this interpretation, as it was Mr. Adeeb who took the initiative and called the meeting with creditors at which he revealed both the transfers and his already commenced efforts to unravel those transfers.[342]

Yet, *Adeeb* also allows for a discharge despite a certain degree of pressure by creditors. After all, it was the creditors who forced Adeeb into bankruptcy with an involuntary petition.[343] Also, it is unlikely that any debtor would voluntarily unravel a transfer unless some degree of pressure was applied in the first place. The typical transferor is likely to leave a suspect transaction intact until he perceives unravelling as a necessary or unavoidable means of placating creditors.

Indeed, the involuntary bankruptcy in *Adeeb* is an extreme form of creditor pressure, but this did not prevent the Ninth Circuit from permitting discharges for involuntary bankrupt parties afflicted with prior fraudulent transfers. In addition to its other holdings, the court specifically devised a three-prong test for involuntary filings that permits a discharge if:

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[339] *Id.* (citing *In re* Esgro, Inc., 645 F.2d 794, 798 (9th Cir. 1981)).
[340] *Id.*
[341] *Id.* at 1346.
[342] *In re Adeeb*, 787 F.2d at 1341-42.
[343] *Id.* at 1342.

1. The debtor discloses the transfers to his creditors;
2. The debtor is making a good faith effort to recover assets at the time the involuntary petition is filed; and,
3. The debtor actually recovers the property "within a reasonable time after" the involuntary petition is filed.[344]

This test illustrates that even debtors forced into bankruptcy are allowed a chance to make amends and obtain relief. Further, it appears that some unspecified degree of creditor and judicial pressure is allowable before a debtor irretrievably loses his right to a discharge.[345]

*Adeeb* and its progeny have been criticized in the Eleventh Circuit. Specifically, in *In re Davis*,[346] the Eleventh Circuit held that the term "transfer" applied even to conveyances that were voluntarily unravelled by a debtor before filing a bankruptcy petition.[347] The court concluded that the term "transfer" was "plain and unambiguous" and rejected *Adeeb*'s reasoning when denying the debtor's discharge.[348] However, *Davis* and its rationale are debatable, at best, and simply wrong, at worst.

Statutory words and phrases are to be given their "plain meaning," which even *Davis* recognizes.[349] Since a transfer that is voluntarily undone is, in practical terms, tantamount to no transfer at all, it is very natural to conclude that "transfer" does not encompass transactions that have been reversed. A reasonable judge could easily conclude that *Davis* picked the right rule of construction, but then wrongly applied it to the word "transfer." Further, even the statutory definition of the term cuts

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[344] *Id.* at 1346.

[345] Note, however, that *Adeeb's* language is unclear as to the timing requirement for the disclosure prong. The opinion can be read to require pre-filing disclosure or, alternatively, to allow for post-filing disclosure. On policy grounds, the latter reading is more appropriate, provided disclosure is made promptly after filing. A debtor may be in the process of voluntary unravelling, but may not have yet disclosed the transfers by the time the involuntary petition is filed. Nondisclosure could be based on any one of a variety of valid reasons. For instance, even a good faith debtor may want to delay or avoid the embarrassment associated with admitting that he had erred in making the transfers in the first place. Likewise, a debtor hoping to negotiate a settlement may consider it advantageous to postpone disclosure until he can also disclose total rectification. Full disclosure coupled with full correction could certainly be a weighty sign of good faith and could have a favorable psychological impact on a debtor's negotiations with his creditors. However, that bargaining advantage could be lost if a debtor's disclosure occurred before total correction. A creditor might understandably be skeptical or angered in the absence of total correction. Accordingly, a debtor might refrain from disclosure to avoid or minimize a backlash of creditor opinion.

[346] 911 F.2d 560 (11th Cir. 1990).

[347] *Id.* at 562.

[348] *Id.*

[349] *Id.*

against the Eleventh Circuit's view that a voluntarily unravelled transfer is a "disposing of or parting with" an asset or property.[350] If property has been reacquired, then nothing was ever really lost, and a court could reasonably conclude that the statutory requirement of "parting" or "disposing" is absent. This is particularly true if the reversal occurred shortly after the purported transfer. Therefore, *Davis* is suspect on simple grounds of textual interpretation. Given the compelling policy grounds behind the Ninth Circuit's reasoning, *Adeeb* is the better view.

Other courts seem to agree with this opinion. For example, bankruptcy courts have cited *Adeeb*, favorably commented on it, or otherwise invoked its rationale.[351] At least one bankruptcy court has even extended *Adeeb*. In *In re Barney*, the court decided that a debtor who delayed disclosure and unravelling efforts until after filing bankruptcy can still obtain a discharge in the face of alleged fraudulent transfers, provided disclosure occurs at or before the first meeting of creditors and the debtor has the "present ability" to "recover substantially all" of the property in question.[352] Under this view, it is not even necessary to actually unravel or disclose the suspect transfers before filing a petition. Simple disclosure early in the case, coupled with the ability to recover assets, will suffice.

*Barney* comports with the long-standing bankruptcy notion that a debtor will not necessarily be denied a discharge because he engaged in fraudulent concealment. The same provision of the Bankruptcy Code (section 727) that bars discharges for debtors who fraudulently transfer assets also bars discharges for debtors who hide assets from creditors.[353] Indeed, the relevant "conceal" and "transfer" language is found in the

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[350] 11 U.S.C. § 101(54) (1994); UFTA § 1(12), 7A U.L.A. at 645.

[351] *See, e.g.*, *In re* Bajgar, 186 B.R. 5, 9 (Bankr. D. Mass. 1995) ("*Adeeb* states the preferable interpretation"); *In re* Sanders, 128 B.R. 963, 971 (Bankr. W.D. La. 1991) ("What may allow discharge is disclosure accompanied by voluntary prepetition reversal of the prohibited activities before harm to creditors has occurred. . . ."); *In re* Rice, 109 B.R. 405, 409 (Bankr. E.D. Cal. 1989) (favorably commenting on *Adeeb* in dicta); *In re* Barney, 86 B.R. 105, 109-10 (Bankr. N.D. Ohio 1987) (applying and extending *Adeeb*).

[352] *Barney*, 86 B.R. at 110. One of the first events in a bankruptcy is the "Section 341 Meeting," which is sometimes referred to as the first meeting of creditors. Pursuant to the Bankruptcy Code, the case trustee and creditors are all given an opportunity to exam the debtor under oath. 11 U.S.C. §§ 341-344 (1994). *Barney* held that "the first meeting of creditors is, in many ways, the moment of 'truth' for the debtors." *Barney*, 86 B.R. at 110. Accordingly, debtors who make disclosure and commence unravelling by the first meeting of creditors will not be denied a discharge due to fraudulent transfer.

[353] 11 U.S.C. § 727(a)(2) (1994) (prohibiting creditor from concealing the property or permitting a third party to engage in concealment).

very same statutory sentence.[354] Both the fraudulent concealment and fraudulent transfer provisions deny discharges to debtors who intend to "hinder, delay, or defraud" creditors.[355] Stated differently, both are designed to punish dishonest debtors who intentionally withhold assets from creditors.

The "fraudulent concealment" passage of the Code, and its predecessor under the old Bankruptcy Act, have routinely been interpreted to mean that concealment will not bar a discharge if the property is disclosed to creditors at or before the first meeting of creditors.[356] In other words, a concealment is not a concealment unless the property stays concealed.

Moreover, acts of fraudulent concealment and fraudulent transfer are virtually the same thing. The only difference is that a transfer necessarily entails a third party, whereas a concealment may or may not involve other persons.[357] Given the similarity of the offenses involved, as well as the obvious similarity of rationales behind the two provisions, it makes sense for courts to accord uniform interpretation to the "transfer" and "concealment" clauses of section 727(a)(2). Otherwise, virtually identical provisions in the same sentence will be given disparate treatment.

Accordingly, in virtually every jurisdiction except the Eleventh Circuit, the *Adeeb - Barney* rationale provides planners and their clients with a very valuable option. Under these cases, asset protection plans are merely a first line of defense, since bankruptcy is still available as a final option. Clients, therefore, have little or nothing to lose by erecting protective structures. If planning works, they have sheltered at least some of their wealth, but if a plan fails, they can still retreat to bankruptcy court.

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[354] *Id.*

[355] *Id.*

[356] *See, e.g., In re* Doody, 92 F.2d 653, 655 (7th Cir. 1937) (holding that when a bankrupt fully discloses the transaction in question at the first meeting of the creditors, fraudulent concealment has not been proven); *In re* Wolmer, 57 B.R. 128, 131-32 (Bankr. N.D. Ill. 1986) (same); *In re* Waddle, 29 B.R. 100, 103 (Bankr. W.D. Ky. 1983) (same).

[357] For instance, a fraudulent concealment could involve something as simple as hiding valuables in a lockbox or a hole in the ground. A fraudulent transfer is ultimately an act of concealment as well, as the debtor is trying to hide his assets from creditors. However, the method of hiding involves a false claim that true ownership is vested in a third person.

## VI. CONCLUSION

Asset protection planning is not inherently fraudulent, despite UFTA's seemingly absolute ban on transfers made with the intent to hinder, delay, or defraud creditors. As shown above, many future plaintiffs do not have "claims," and do not even amount to "creditors" under UFTA. UFTA also imposes a "rule of reason" that requires transferors to protect against reasonably foreseeable claims, as recognized by today's law. The statute does not require transferors to protect against claims that are not reasonably foreseeable, and this limitation fully conforms with many other areas of law. In this country, transferors who intentionally create reserves to protect their legitimate creditors, and who restrict their asset protection planning to their surplus assets, are intentionally protecting their creditors. This negates any fraudulent intent, even when good faith mistakes in calculations or financial assumptions are later discovered.

There are also many other key technical or legal concerns that limit UFTA's reach. For instance, passage of time is recognized as a valid defense. Also, UFTA does not consider all transactions to be "transfers" and practically invites transfers by solvent people under a type of "no harm, no foul" rule. Finally, if all else fails, a debtor still has the ultimate fallback of bankruptcy, provided that he discloses the allegedly fraudulent transfer and then recovers the relevant property. Consequently, asset protection planning is a perfectly legitimate option and, properly undertaken, can peacefully co-exist with the limited constraints imposed by UFTA in connection with future creditors.