FUTURE CREDITORS AND FRAUDULENT TRANSFERS: WHEN A CLAIMANT DOESN'T HAVE A CLAIM, WHEN A TRANSFER ISN'T A TRANSFER, WHEN FRAUD DOESN'T STAY FRAUDULENT, AND OTHER IMPORTANT LIMITS TO FRAUDULENT TRANSFERS LAW FOR THE ASSET PROTECTION PLANNER

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I. INTRODUCTION

Asset protection planners are a new breed of attorney which has been spawned by the perception that America's litigation system has run amok. The rapid growth in the number of asset protection planners is reflected in the sudden appearance of new literature devoted exclusively

to this practice area.[1] Attorneys who practice asset protection law have a very basic mission in their professional lives: to systematically devise ways to shelter client assets from lawsuits. Simply stated, asset protection planners seek to frustrate plaintiffs who might someday try to collect from the planners' client.

Many planning strategies unabashedly entail taking assets out of a client's name, placing those assets in the name of another person while vesting the client with substantial control over the transferred assets. A large number of such transfers are prompted by a vague, ill-defined concern that someday in the future, somewhere out in the realm, somebody might file some type of suit against the client. Worst of all, in the nightmare scenario feared by many clients, this faceless prospective litigant will actually obtain a large judgment and thus become a creditor entitled to collect, thereby hurling the client into financial ruin. Planning seeks to shelter assets from that potential calamity by placing them beyond the reach of such future creditors.

The mission of the asset protection planner is impeded by the Uniform Fraudulent Transfers Act (UFTA),[2] which superficially appears to illegitimize the whole notion of asset protection planning. UFTA section 4(a)(1) states:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor.[3]

This language raises a very basic question: How does one reconcile the notion of asset protection planning with UFTA? Since asset protection planning is now a burgeoning practice area, the answers to this question can have a profound impact on the day-to-day life of many attorneys and clients. If UFTA's terms are to be taken literally and read broadly, then asset protection planning is nothing but an illicit attempt to defraud creditors. However, if there are limits to this statutory language,

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[1]*See, e.g.*, PETER SPERO, ASSET PROTECTION: LEGAL PLANNING AND STRATEGIES (1994).

[2]7A U.L.A. 639 (1984).

[3]UFTA § 4(a)(1), 7A U.L.A. at 652.

then at least some asset transfers do not implicate UFTA's proscriptions, and asset protection planning becomes legitimate to the extent that it involves transfers that are not prohibited by UFTA. Further, the more limited UFTA might be, the more leeway there is for transfers that form a protection plan.

The short answer to the question is that UFTA section 4(a)(1) is not to be taken literally and is not an absolute bar to every transfer prompted by fear of plaintiffs who might sue in the future. Hence, the main thesis of this article is straightforward — future creditors have rights, but those rights have limits. The most significant right of future creditors is the right to relief in cases involving persons who denude themselves of assets and then undertake dishonest or high risk endeavors. However, there are also some very significant limits on the rights of future creditors.

As a legal matter, transferors need only consider today's law, and they are not obligated to base their planning and transactions on the unpredictable and speculative law of the future. Clients are therefore free to act today to insulate themselves from tomorrow's possible new theories of liability. Additionally, there is an important factual limit to a transferor's obligation to consider the rights of future plaintiffs. Transferors must consider and plan for reasonably foreseeable future liabilities only. They are not obligated to account for future debts that are not reasonably foreseeable.

Thus, clients have latitude to protect against outrageously large jury verdicts or court judgments that might arise in the future. The parameters of this right are expressed by a simple mathematical construct set forth in this article and dubbed the "Long Range Solvency Calculation." Furthermore, passage of time, notice to prospective creditors, and other concepts also work to limit the reach of UFTA section 4(a)(1) and its availability to future creditors. Finally, if all else fails, a client will in many instances still be able to seek bankruptcy protection, even if his prior transfers were made with fraudulent intent.

These conclusions are based on several factors. First and foremost is the text of the statute itself, which employs defined terms that limit UFTA. It is well settled that some creditors have fewer constitutional rights then other creditors,[4] but it is equally well settled that the

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[4]*See, e.g.*, Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478 (1988). In *Pope*, the Court examined Oklahoma's "nonclaim" statute that governed the time limits in which creditors needed to present claims against a decedent's estate. *Id.* at 479. Under the Oklahoma statute, the clock began to run on creditors upon the estate's notice by publication of the commencement of probate, which meant a newspaper notice. *Id.* at 480-81. The Court struck

legislature has broad latitude in enacting economic legislation such as UFTA.[5] This means that the legislature can provide more rights than might be accorded by the Constitution. Therefore, it becomes exceedingly important to understand the relevant legislation, which, in turn, prompts this article to focus on statutory interpretation.

Other commentators frequently gloss over or ignore UFTA's statutory text and instead rely almost solely upon case law. In an effort to fill this analytical gap, this article examines the words of the statute itself and also the accompanying comments provided by the draftsmen, who were the Commissioners on Uniform Laws. This is not meant to disparage or belittle the significance of case law or reasoned commentaries, for those authorities are quite valuable, and are also cited at length herein because they act as a second factor that limits UFTA and section 4(a)(1). Nonetheless, UFTA is a statute, and its words must be given primary importance.

Finally, as a third factor, policy arguments also bolster these conclusions. Some of these policy arguments are made in the case law, some are articulated by the Commissioners, at least one is supplied by another commentator, and others originate from this author. Such policy arguments appear throughout this article at various points, and all support the view that there are sharp limits on the rights of future creditors. As a result of these limits, careful planners will have ample opportunity to lawfully protect assets from future litigants without violating UFTA's constraints.

II. BACKGROUND ON UFTA AND SCOPE OF ARTICLE

In order to understand the precise scope of the questions raised by UFTA section 4(a)(1), and to understand the limited reach of this article, it helps to first have a more generalized understanding of UFTA.

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down the statute and held that due process required actual notice of probate to "known or reasonably ascertainable creditors," and that notice by publication was insufficient for such creditors. *Id.* at 490. However, as to other creditors, the Court stated, "Nor is everyone who may conceivably have a claim properly considered a creditor entitled to actual notice. . . . [I]t is reasonable to dispense with actual notice to those with mere 'conjectural' claims." *Id.* (citations omitted). *See also* 3 DANIEL R. COWANS, COWANS BANKRUPTCY LAW AND PRACTICE § 12.3, at 11 (6th ed. 1994) (stating that "[o]nly creditors and reasonably foreseeable claimants are entitled to notice" of the commencement of bankruptcy proceedings).

[5]*See, e.g.*, Nebbia v. New York, 291 U.S. 502, 537 (1934) ("[A] state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose.").

A. *General Background*

UFTA was drafted by the Commissioners on Uniform Laws and has been adopted by thirty-seven states.[6] It is intended to succeed and replace the older Uniform Fraudulent Conveyances Act (UFCA).[7] One important reason for promulgating and adopting UFTA was the desire to make state law conform with the Bankruptcy Reform Act's changes in federal bankruptcy fraudulent transfer law.[8]

Accordingly, UFTA frequently parallels key passages of the United States Bankruptcy Code (the Code) in nearly verbatim form, which makes opinions under the Code a valuable source of interpretive case law.[9] In addition to this unique similarity between UFTA and the Code, there is also a more generalized interdependence of interpretive case law: UFTA, UFCA, and the relevant Bankruptcy Code provisions are all direct lineal descendants of the original fraudulent conveyances laws of England — including Parliament's Statute of Elizabeth[10] and the related holdings of early common law courts[11] — and all of these bodies of law share a common purpose. Consequently, cases that are interpreting one statute are often relied upon when interpreting another.[12] Indeed, the aims of UFTA and the early common law are so similar and unchanged over the years that the ancient and seminal Star Chamber opinion of *Twyne's Case*[13] is still relied upon by contemporary courts[14] and draftsmen.[15] The

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[6]*See* UFTA, 7A U.L.A. 217 (Supp. 1997).

[7]UFTA, 7A U.L.A. 639, 639-42 (1984). Those states that have not adopted UFTA have either adopted UFCA or some other version of the Statute of Elizabeth. Hence, fraudulent transfers issues are present in every state in the Union. *Id.*

[8]*See id.* at 639.

[9]*Compare* 11 U.S.C. § 548 (1994), *with* UFTA (using similar language). Congress has also enacted a federal law version of UFTA that applies to transfers made by persons indebted to the federal government. 28 U.S.C. § 3306 (1994). This provision uses language that is similar to UFTA in many regards, although there are some differences.

[10]An Acte Touching Orders for Banckruptes, 1571, 13 Eliz., ch. 7 (Eng.). *See also* Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 644-45 (3d Cir. 1991)("Section 548 [of the Bankruptcy Code] is derived from the Statute of 13 Elizabeth passed by Parliament in 1571.").

[11]The most notable of these early decisions is Twyne's Case, 3 Coke 80b, 76 Eng. Rep. 809 (Star Chamber 1601). *Twyne's Case* still retains vitality today. It is expressly cited by the Commissioners in their official comments to UFTA, and is still cited as viable precedent. UFTA § 4, cmt. 5, 7A U.L.A. 639, 654 (1984).

[12]*See, e.g.*, Advest, Inc. v. Rader, 743 F. Supp. 851, 853-55 (S.D. Fla. 1990) (noting that the UFTA can be interpreted by using cases which interpreted earlier state statutes because the UFTA codifies earlier statutory law); UFTA § 4, cmt. 5, 7A U.L.A. 639, 654 (1984) (referring to Twyne's Case), UFCA, and the Statute of Elizabeth); UFTA § 1, cmt. 2, 7A U.L.A. at 645 (referring to UFCA and the Statute of Elizabeth).

[13]Twyne's Case, 3 Coke 80b, 76 Eng. Rep. 809 (Star Chamber 1601).

law of fraudulent transfers is therefore ancient, time honored, and well recognized.

UFTA's purpose is straightforward and simple. The statute is intended to protect unsecured and undersecured creditors from the effects of debtor transfers designed to frustrate creditors' efforts to collect on debts.[16] A classic example of such transfers is a debtor spouse subject to a money judgment who "buries" the titles to the house, car, stocks, bank accounts, and other assets in the other spouse's name. The obvious and transparent intent behind this ploy is to leave the judgment debtor with no assets in order to frustrate the creditor's collection efforts, while still allowing the debtor to retain the control, benefit, and use of the assets through the auspices of his or her spouse.

To neutralize such tactics, and to foster the objective of protecting the unsecured and undersecured, UFTA provides creditors with a variety of remedies. The most important remedy is the creditor's right to avoid a transfer to the extent necessary to satisfy his claim. This enables the creditor to levy and execute on any property that was taken out of the debtor's name.[17] A creditor may also seek money damages from the transferee[18] or obtain a variety of equitable pre-judgment relief.[19] All this

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[14]*See, e.g.*, McKinley Fed. Sav. & Loan v. Pizzuro Enters., 585 N.E.2d 496, 500 (Ohio Ct. App. 1990) (relying upon and citing Twyne's Case).

[15]*See supra* note 12.

[16]*See* UFTA, § 1, cmt. 3, 7A U.L.A. 639, 646 (1984) ("[T]he purpose of this Act is primarily to protect unsecured creditors."); UFTA, § 3, cmt. 2, 7A U.L.A. at 651 ("[T]he purpose of the Act [is] to protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors.").

[17]UFTA § 7(a)(1), 7A U.L.A. at 660. Note that, as between the transferee and the rest of the world other than the creditor obtaining relief, the transfer remains valid. The "rest of the world" includes the transferee. This result accrues because many (if not all) states do not revest title in the transferor if fraud is found. Instead, the transfer is void only as to the petitioning creditor, who may levy on the property as if the transfer never occurred. As to the transferee, the transferor, and all others, the transfer remains good. Stratton v. Edwards, 54 N.E. 886, 887 (Mass. 1899) ("It is well settled that conveyances in fraud of creditors are good as between the parties to them, and, except as to creditors, will be upheld."); Roth-Zachry Heating, Inc. v. Price, 713 P.2d 634, 637 (Or. Ct. App. 1986) ("[T]he effect of the judgment is to hold the transfer void only as to creditors but to recognize it as binding on the parties involved."). The transferee should keep anything remaining after creditors levy and execute on the property, but would lose whatever creditors levy on.

Note that UFTA's remedies are nonexclusive, UFTA § 7(a)(3)(i)-(iii), so a creditor can also seek other relief, such as a constructive trust or other appropriate measures. 7A U.L.A. 639, 660 (1984).

[18]UFTA § 8(b), 7A U.L.A. 639, 662 (1984).

[19]UFTA § 7(a)(2) allows a court to appoint a receiver, issue injunctions (including a freeze order against the transferee and transferor), order pre-judgment attachment on the property, or fashion any other provisional remedies as the circumstances of the case may

makes UFTA a potent weapon for frustrated creditors confronted by debtors who have stripped themselves of assets.

B. *Two Types of Fraud, Two Types of Creditors, and Topics Addressed*

UFTA concerns itself with two types of "fraud"[20] and two types of

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require. 7A U.L.A. 639, 660 (1984). In the Official Comments to UFTA § 7, the Commissioners cite several cases as examples of the right to proceed against a transferor before judgment, including Lipskey v. Voloshen, 141 A. 402 (Md. 1928); Matthews v. Schusheim, 235 N.Y.S.2d 973 (N.Y. 1962); Oliphant v. Moore, 293 S.W. 541 (Tenn. 1927). 7A U.L.A. 639, 661 (1984). Each of these cases granted relief before any judgment was rendered on the underlying claims. *Matthews* was conditionally reversed, contingent upon the defendant posting a bond in lieu of pre-judgment relief, but was otherwise affirmed. *See* Matthews v. Schusheim, 236 N.Y.S.2d 407 (N.Y. 1962).

In one case, a motion to enjoin payment of attorney fees with the allegedly fraudulently transferred property was denied as an undue burden on defendants, but fee payments with such funds were subject to prior approval by the Court. *In re* Poole, 15 B.R. 422, 433-34 (Bankr. N.D. Ohio 1981).

An injunctive "freeze order" as to attorney fees raises serious constitutional questions regarding due process and the right to counsel, especially since there is some indication that fraudulent transfers may also result in criminal liability under federal law. *See, e.g.*, United States v. Feldman, 853 F.2d 648, 654 (9th Cir. 1988) (regarding the federal mail fraud statute, 18 U.S.C. § 1341 (1994)); Money Laundering Control Act, 18 U.S.C. § 1956 (1994). Fraudulent transfers may also result in criminal liability under some state statutes. See *infra* note 156 for state statutory citations.

[20]The term "fraud" should be used with caution in connection with UFTA. Traditional fraud is an intentional tort that includes elements of misrepresentation or omission and, additionally, reliance (usually "justifiable" or "reasonable" reliance). *See, e.g.*, W. PAGE KEETON, ET AL., PROSSER & KEETON ON TORTS § 105, at 728 (5th ed. 1984). Moreover, the plaintiff's reliance must be induced by the misrepresentation or omission in question. *Id.* While intent can be an element of a fraudulent transfer, the facts giving rise to a fraudulent transfer may be devoid of misrepresentation, and are even more apt to lack any hint of reliance, as the challenged transfer is in many instances made without any communication to the plaintiff, and in some cases is accompanied by an affirmative effort to hide these facts from plaintiff. Arguably, the fraudulent transferor seeks to misrepresent true ownership of assets to the whole world, including plaintiff, and this might be said to be a misrepresentation for fraud purposes. However, without communicating this alleged sham ownership to the plaintiff, it is difficult to see a misrepresentation within the normal meaning of common law fraud.

Reliance is even more problematic. In some cases, a transferor may have intentionally misrepresented ownership in order to induce an extension of credit, as suggested in Schreyer v. Platt,* 10 S. Ct. 579, 580-81 (1890), in which case a fraudulent transfer might also be a common law fraud. However, absent such circumstances, a plaintiff will often be unable to show any reliance (justifiable, reasonable or otherwise) on the defendant's ownership, thus once

*United States Reports, Volume 134, erroneously labelled this case "Schreyer v. Scott." In an effort to provide a proper citation and alleviate any confusion, the *Journal* will use the Supreme Court Reporter citation, which contains the proper title.

creditors. The two types of fraud are often referred to as "actual" fraud and "constructive" fraud.[21]

Actual fraud focuses on the transferor's intent. This is established by the statutory language of UFTA section 4(a), which states, "A transfer . . . is fraudulent as to a creditor . . . if the debtor made the transfer . . . with *actual intent to hinder, delay, or defraud any creditor* of the debtor."[22] Moreover, the transferor's intent at the time of transfer is the *only* relevant factor: Intent alone is the key to understanding actual fraud[23] The economic effect of a transfer has no bearing whatsoever,[24]

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again precluding common law fraud. Moreover, under one UFTA provision dealing with certain types of "constructive fraud," the statutory elements encompass negligent as well as intentional misconduct. *See* UFTA § 4(a)(2)(ii), 7A U.L.A. 639, 658 (1984) (asking whether the debtor "intended to incur, or believed or *reasonably should have believed* that he [or she] would incur, debts beyond his [or her] ability to pay as they became due") (emphasis added) (brackets in original). It is therefore incorrect to automatically equate a fraudulent transfer with a fraud, particularly in those cases where UFTA claims are ultimately grounded on negligence-like grounds. Using the word "fraud" to describe ordinary negligence unfairly taints a defendant and violates the well established principle that persons should not be tarnished with fraud allegations, unless such allegations are well grounded. *See* FED. R. CIV. P. 9(b) (requiring fraud to be pled with particularity); DiVittorio v. Equidyne Extractive Indus., Inc., 822 F.2d 1242, 1247 (2d Cir. 1987) ("Rule 9(b) is designed to . . . protect[ ] a defendant from harm to his reputation or goodwill . . . .); Korodi v. Minot, 531 N.E.2d 318, 321 (Ohio Ct. App. 1987) ("[P]articularity is required to protect defendants from the potential harm to their reputations which may attend general accusations of acts involving moral turpitude.").

[21]*See, e.g.*, Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 645 (3d Cir. 1991); *In re* Revco D.S., Inc., 118 B.R. 468, 510 (Bankr. N.D. Ohio 1990).

[22]UFTA § 4(a), 7A U.L.A. 639, 652 (1984) (emphasis added). Fraud is described and made actionable by two UFTA sections, §§ 4 and 5. Section 4 deals with fraud against future and present creditors, and proscribes both actual and constructive fraud. *Id.* at 652-53. Section 5 is unconcerned with future creditors, and deals only with claims by present creditors. Moreover, the transferor's intent is irrelevant to a claim under UFTA § 5. Section 5(a) deals only with questions of economic effects of a transfer. Section 5(b) also considers the economic effect of a transfer, but then goes a step further. Section 5(b) requires proof that the transferee, not the transferor, acted while having "reasonable cause to believe that the debtor [i.e., the transferor] was insolvent." *Id.* § 5(a)-(b), 7A U.L.A. at 657. Moreover, § 5(b) is limited to claims against "insiders," who are persons with a close connection to the debtor, such as a relative, a general partner of the debtor's, a corporation controlled by the debtor, and other similar close affiliates. *See* UFTA § 1(7), 7A U.L.A. at 644-45 (defining "insider"), *id.* § 1(1), 7A U.L.A. at 643 (defining "affiliate").

[23]*See, e.g.*, Roland v. United States, 838 F.2d 1400, 1402 (5th Cir. 1988) (applying Texas law) ("[T]he debtor's intent at the time of the conveyance was the crucial element."). Another example is *In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 392 (Bankr. S.D. Fla. 1991) (citations omitted), in which the bankruptcy court said, "As the fraud rests upon the debtor's intent, *it must exist at the time of the transfer.*" *Id.* All of this comports with ancient and long-standing common law. "The Statute of Elizabeth focused on the bad intent of the debtor to avoid paying his obligations. . . . [I]t is, in fact, actual subjective bad intent that is the necessary requisite to be proven before a transfer can be deemed to have been fraudulent under the Statute of Elizabeth." *Id.* at 391 (applying Florida's version of the Statute of Elizabeth,

except to the extent that, in some cases, post-transfer insolvency may itself be an indicia of intent.[25]

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which was in effect until replaced with UFTA in 1988).

[24]See *Roland*, 838 F.2d at 1403 ("Under the intent test . . ., whether [the debtor] was solvent at the time of the transfer is not dispositive. The crucial element was his *intent* at that time.").

[25]Under UFTA § 4(b)(9), insolvency can be an indicator that the debtor acted with intent to defraud creditors. 7A U.L.A. 639, 653 (1984). See *infra* Part II.C regarding the "badges of fraud."

American jurisdictions are divided on the question of just how particularized a debtor's fraudulent intent must be to incur UFTA liability. Some states hold that a debtor's intent to defraud *any* creditor — present or future — is sufficient to establish intent to defraud future creditors. This view is summarized as follows:

> [T]he general rule . . . is that every conveyance made with actual intent . . . to hinder, delay, or defraud *either* present or future creditors is fraudulent as to *both* present and future creditors . . . . [I]t is generally deemed not to be necessary that the transferor's intention to defraud should have been directed against any particular person.

37 AM. JUR. 2D *Fraudulent Conveyances* §§ 139-140 (1968) (emphasis added). Under this view, fraud exists against future creditors even if the debtor had actual fraudulent intent only as to present creditors. All creditors are treated as one class, no distinction is made between present and future creditors, and the debtor's fraudulent intent as to present creditors is imputed to be fraudulent intent as to future creditors as well. This was sometimes said to be the view at old common law. *See, e.g.*, Williams v. Banks, 11 Md. 198, 245 (1857) (Eccleston, J., speaking for himself) (arguing that subsequent creditors should not be distinguished from previous creditors when a voluntary deed is void because it is fraudulent as to previous creditors by either actual or constructive fraud).

Other states hold that a creditor must prove his case with more targeted evidence showing an intent to defraud future creditors as a class. Hence, the "general rule" referred to above is not uniform.

> [I]n a number of jurisdictions, both under the [UFCA] and under other statutes, a general fraudulent intent has been held insufficient, and a subsequent creditor has been permitted to set aside the conveyance only where it appeared that the intention to defraud was specifically aimed at subsequent creditors, or at least at the plaintiff.

37 AM. JUR. 2D *Fraudulent Conveyances* § 140 (1968). In other words, many states hold that it is necessary to prove intent to defraud future creditors as a specific class.

A minority of states expressly or apparently hold that there is no fraud against future creditors unless the debtor acted with fraudulent intent *vis-a-vis* a particular creditor. Indeed, there is very respectable authority for the view that future creditors must show a specific intent to defraud the plaintiff. The Fifth Circuit, in applying Texas law, stated, "A *subsequent* creditor could reach a grantor's interest in property conveyed to others *if that transfer was made with intent to defraud that particular creditor.*" *Roland*, 838 F.2d at 1402 (applying Texas law) (emphasis in original and added); *accord* United States v. Chapman, 756 F.2d 1237, 1242 (5th Cir. 1985). Florida's courts also seem to adhere to this minority view, although not as clearly as Texas. Hence, one court referred to future creditors in the singular: "[A] creditor has a cause of action to set aside a debtor's conveyance that took place before the creation of the debt, but only if the debtor intended to defraud the subsequent creditor." Hurlbert v. Shackleton, 560 So. 2d 1276, 1279 (Fla. Dist. Ct. App. 1990) (citation omitted) (applying

The other type of fraud — constructive fraud — is essentially unconcerned with intent and instead focuses upon economic effect. This is evident in the language of UFTA, which requires creditors to prove *both* of two things to mount a constructive fraud case:

1. The debtor transferred an asset or incurred a debt "without receiving a reasonably equivalent value in exchange for the transfer or obligation,"

2. "[A]nd the debtor" did either of the following:

   a. "[W]as engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or"

   b. "[I]ntended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due."[26]

Similarly, UFTA section 5(a) focuses solely upon economic effect, as shown by the following language:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation *without receiving a reasonably equivalent value* in exchange for the transfer or obligation *and* the debtor *was insolvent* at that

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Florida's version of the Statute of Elizabeth, which has since been replaced with UFTA). Under this minority view, sometimes dubbed the "particular future creditor" view, it is virtually impossible to prove actual intent as to future creditors. *Id.* at 1280 (Barfield, J., dissenting). By definition, future creditors are persons who did not even have a claim against the debtor at the time the debtor made the relevant transfers. Hence, the run-of-the-mill future creditor is left with an impossible task in "particular future creditor" jurisdictions: How can a plaintiff prove actual intent to defraud a particular creditor who did not even exist at the time of the transfer? Absent extraordinary circumstances (such as a case where the debtor made transfers in anticipation of a conscious plan to injure a particular plaintiff), most future creditors will unable to prove their claims.

[26]UFTA § 4(a)(2)(i)-(ii), 7A U.L.A. 639, 653 (1984) (brackets in original).

> time *or* the debtor *became insolvent* as a result of the transfer or obligation.[27]

Consequently, under either section 4 or section 5, the elements of constructive fraud are twofold: A lack of "reasonably equivalent value" (REV) *and* what can generally be called insolvency, either on a thin capital, balance sheet or cash flow basis.[28]

Creditors are also split into two groups, "present" creditors, and "future" (or "subsequent") creditors. Statutory definitions govern a creditor's classification. The difference between a "present" creditor and a "future" creditor is merely a matter of timing, as shown by UFTA's explicit "before" and "after" test. If "the creditor's claim arose *before* . . . the transfer was made or the obligation was incurred,"[29] then the creditor is a "present" creditor.[30] However, if "the creditor's claim arose . . . *after* the transfer was made or the obligation was incurred,"[31] then the creditor is a "future" or "subsequent" creditor.

The relation between the various types of fraud and creditors is summarized by the following matrix:

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[27]*Id.* § 5(a), 7A U.L.A. at 657 (emphasis added).

[28]*See In re* Xonics Photochemical, Inc., 841 F.2d 198, 202 (7th Cir. 1988) (referring to "reasonably equivalent value" (REV) and "insolvent"); *In re* Janz, 140 B.R. 256, 258 (Bankr. D. N.D. 1991) (requiring both a showing of insolvency and a showing of inadequate consideration). The presence or absence of REV is tested from the perspective of creditors. *See 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) ("fair consideration" under UFCA "must be determined from the standpoint of creditors").

[29]UFTA § 4(a), 7A U.L.A. 639, 652 (1984) (emphasis added).

[30]*See also id.* § 5(a)-(b), 7A U.L.A. at 657.

[31]*Id.* § 4(a), 7A U.L.A. at 652.

CONCEPTUAL MATRIX: UFTA

	ACTUAL FRAUD (Looks to Intent)	CONSTRUCTIVE FRAUD (Looks to Effect)
FUTURE CREDITORS	Actual Future Fraud	Constructive Future Fraud
PRESENT CREDITORS	Actual Present Fraud	Constructive Present Fraud

As shown by this matrix, there are only four possible classes of UFTA violations. The most troublesome issue for planners and clients involve the northwest quadrant of the matrix: Actual future fraud, which is an act of actual fraud committed against future creditors. In relative terms, it is easier to plan around the other three quadrants.[32] Consequently, this article will focus primarily on issues that relate solely to actual future fraud. Additionally, this article also deals with issues that are primarily related to actual present fraud but which also bear on actual future fraud.

[32]For example, the short and simple way to avoid defrauding present creditors is to pay all outstanding debts.

Matters of constructive fraud are also easy to resolve. A planner merely needs to enter the statutory safe harbors provided by UFTA § 4(a)(2), 7A U.L.A. at 652. Recall that constructive fraud consists of two elements—a lack of "reasonably equivalent value" (or REV) *and* insolvency (either on a thin capital, balance sheet or cash flow basis). *Id.* § 4(a)(2), 7A U.L.A. at 653. If a transaction avoids insolvency, and/or involves an exchange of REV, then there is no constructive fraud. Consequently, a little thoughtfulness in planning can easily avoid the constructive fraud pitfall.

C. *Using the Badges of Fraud to Prove Actual Fraud*

UFTA allows the fact finder to consider a wide range of factors that might be probative of whether the transferor acted with improper intent at the time of transfer.[33] These factors, which are commonly referred to as the "badges of fraud," are partially set forth in UFTA section 4(b).[34] The statutory badges of fraud are "a nonexclusive catalogue of factors appropriate for consideration by the court in determining whether the debtor had an actual intent to hinder, delay, or defraud one or more creditors."[35] UFTA's statutory badges of fraud are grounded in long standing common law precedent, dating back to Lord Coke's opinion in *Twyne's Case*.[36]

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[33]*Id.* § 4(b), 7A U.L.A. at 653.

[34]*See, e.g.*, *In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 392 (Bankr. S.D. Fla. 1991) (referring to "badges of fraud"). As to the statutory badges, § 4(b) states:

> In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:
> (1) the transfer or obligation was to an insider;
> (2) the debtor retained possession or control of the property transferred after the transfer;
> (3) the transfer or obligation was disclosed or concealed;
> (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
> (5) the transfer was of substantially all the debtor's assets;
> (6) the debtor absconded;
> (7) the debtor removed or concealed assets;
> (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
> (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
> (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and,
> (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Id. § 4(2)(b), 7A U.L.A. at 653.

[35]*Id.* § 4, cmt. 5, 7A U.L.A. at 654.

[36]See, e.g., UFTA § 4, cmts. 5-6, 7A U.L.A. at 654-56, for a lengthy sampling of the case law behind the badges of fraud. The statutory badges are supplemented by many other factors noted in case law. For instance:

- Defendant's "fail[ure] . . . to articulate credible reasons for making the conveyances in the manner in which he did." United States v. Christensen, 751 F. Supp. 1532, 1537 (D. Utah 1990).
- A pattern of suspicious transfers, see, e.g., *id.* (demonstrating a pattern of transferring property to hinder collection of federal tax liabilities), including a focus on the cumulative effect of the pattern. *In re* Reininger-Bone, 79 B.R. 53, 55 (Bankr. M.D. Fla. 1987) ("[T]he existence or cumulative effect of a

Whether specifically enumerated in the statute, grounded in case law, or based on the unique facts of a particular case, the badges of fraud

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pattern or series of transactions or course of conduct after the incurring of debt . . . .").

- Use of trusts, especially if revocable. *See, e.g.*, *Christensen*, 751 F. Supp. at 1534 (concerning language in trust that the transferor retained "the power and the right at anytime during [his] lifetime to amend or revoke in whole or in part the trust") (alteration in original); Citizens State Bank of Hayfield v. Leth, 450 N.W.2d 923, 927 (Minn. Ct. App. 1990) (finding transferor designed trust to be revocable by family and thereby retained control); Twyne's Case, 3 Coke 80b, 76 Eng. Rep. 809, 813 (Star Chamber 1601) ("Here was a trust between the parties, for the donor possessed all, and used them as his proper goods . . . and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud."). Note, however, that the Commissioners do not consider the use of trusts to be *per se* fraudulent. "[T]he use of the trust is fraudulent only when accompanied by elements or badges specified in this Act." UFTA § 4, cmt. 5, 7A U.L.A. 639, 654 (1984).
- Sham sale-leasebacks. For example, a transferor purports to sell an asset to a transferee and then purports to lease the asset back from the transferee, but in fact, the transferor never pays rent and the transferee exercises little or no control or use over the asset. *See, e.g.*, United States v. Taylor, 688 F. Supp. 1163 (E.D. Tex. 1987). In *Taylor*, the transferors also continued to pay real estate taxes and mortgage payments after ostensibly selling the relevant residential real estate to their daughter, who never paid taxes or mortgage payments. *Id.* at 1164.
- Knowingly depleting a business to the ultimate detriment of its unsecured creditors. *In re* Agricultural Research & Tech. Group, Inc., 916 F.2d 528, 536 (9th Cir. 1990) ("Agretech should have known that transferring funds to earlier investors from later investors and not from the proceeds of the underlying business would ultimately operate to the detriment of its creditors."); *In re* Revco D.S., Inc., 118 B.R. 468, 517 (Bankr. N.D. Ohio 1990) ("In general, fraudulent conveyance statutes protect creditors from transfers of property or obligations . . . which deplete assets or increase obligations of a financially impaired debtor.").
- Transfers out by a loan guarantor when the loans are in the process of being called. Citizens State Bank of Hayfield v. Leth, 450 N.W.2d 923 (Minn. Ct. App. 1990) (finding that at the time of the transfer of land to the family trust, the bank had called guarantor to take over loan and transferor had been notified).
- Close relations of any sort between the transferee and the transferor, including friendship and common law marriage. *In re* Reininger-Bone, 79 B.R. 53, 55-56 (Bankr. M.D. Fla. 1987) (finding couple residing together as husband and wife to be a close relationship precluding "an arms-length transaction").
- "[T]he general chronology of events and transactions under inquiry." *Id.* at 55.
- "[U]nusual business practices in the disputed transaction." Tipp v. United Bank of Durango, Col., 745 S.W.2d 141, 143 (Ark. Ct. App. 1988).

Thus, between the statutory and nonstatutory badges of fraud, a creditor has numerous factors he can potentially point to as proof of fraudulent intent.

are always circumstantial evidence from which the fact finder may logically infer fraudulent intent.[37] These logical inferences are permitted because courts are cognizant of the traditional difficulties associated with proving fraudulent intent. Absent a rare admission or declaration against interest[38] by the defendant, a plaintiff is unlikely to discover any direct proof of bad motives because often only the defendant knows his own motivation at the time of the transfer.[39] Hence, the law allows the badges to act as a substitute for direct proof of intent and permits, but does not require, the fact finder to draw inferences of bad intent from them.[40]

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[37]This is in accordance with the general admissibility of indirect evidence that is relevant to, and rationally sustains, logical inferences. *See, e.g.*, FED. R. EVID. 401 (defining "relevant"). *See also* County Court of Ulster County v. Allen, 442 U.S. 140 (1979), in which the Court said:

> Inferences and presumptions are a staple of our adversary system of factfinding. It is often necessary for the trier of fact to determine the existence of an element of the crime — that is, an "ultimate" or "elemental" fact — from the existence of one or more "evidentiary" or "basic" facts.
>
> . . . .
>
> The most common evidentiary device is the entirely permissive inference or presumption, which allows — but does not require — the trier of fact to infer the elemental fact from proof by the prosecutor of the basic one and which places no burden of any kind on the defendant. In that situation the basic fact may constitute prima facie evidence of the elemental fact.

Id. at 156-57 (citation omitted).

[38]*See* FED. R. EVID. 801(d)(2) (dealing with admissions by party opponents), *id.* 804(b)(3) (dealing with declarations against interest). *See also* FED. R. CIV. P. 36 (dealing with requests for admissions).

[39]"[A]ctual intent to defraud is rarely subject to direct proof." *In re* Reininger-Bone, 79 B.R. 53, 55 (Bankr. M.D. Fla. 1987). *Accord In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 391 n.4 (Bankr. S.D. Fla. 1991) ("Because of the difficulty in proving actual subjective bad intent, . . . the Uniform Fraudulent Conveyance Act [was adopted] which enables a court to ignore actual fraudulent intent and look to constructive fraudulent intent.").

[40]*In re* Poole, 15 B.R. 422, 431-32 (Bankr. N.D. Ohio 1981) ("In determining whether a conveyance is made with actual intent. . ., direct evidence of fraudulent intent is not essential and, indeed, in most circumstances, not likely to be available. Consequently, certain traditionally designed 'badges' or indicia of fraud . . . have generally been held to be sufficient to show fraud . . . ."); Stein v. Brown, 480 N.E.2d 1121, 1124 (Ohio 1985) ("Due to the difficulty in finding direct proof of fraud, courts . . . look to inferences from the circumstances surrounding the transaction . . . ."). As stated in an earlier case,

> It has been said that fraud is never presumed, but must always be proved. It is not meant by that, that the fraud must be proved by direct evidence, for a party who commits a fraud always covers up his proceedings in a way that it is difficult, if not impossible, in nearly all cases, to prove the very act or the very intent of the party who has committed the fraud. Therefore, it is always proper to prove fraud by circumstances, and actual fraud is inferred in nearly all cases by the circumstances proved . . . .

Atwater v. Jones, 34 Ohio Cir. Dec. 605, 609-10 (Ohio Ct. App. 1902).

Any badge of fraud is potentially relevant to proving fraudulent intent, but, no single badge alone creates a presumption of bad intent.[41] Indeed, even the most obvious badge of fraud — transfers made during the pendency of a suit — is often inconclusive of fraudulent intent, unless accompanied by more.[42] The fact finder must consider the totality of the circumstances surrounding a transfer,[43] including any evidence negating intent. As the drafters of the UFTA note, "In considering the factors listed in § 4(b) [i.e., the badges of fraud] a court should evaluate all the relevant circumstances . . . . Thus the court may appropriately take into account all indicia negativing as well as suggesting fraud."[44]

D. *The Question: Are Shelters Against Future Claims Inherently Fraudulent?*

Many people make transfers that are motivated, in whole or in part, by a desire to protect themselves and their families from modern American litigation. Most transferors do not have a particular claimant in mind when making conveyances, but are instead motivated by a general fear of potential future claims. These fears are grounded on a seemingly endless onslaught of bizarre claims and awards. Media coverage of these cases heightens public awareness of such strange results, thus making people far more inclined to believe that America's judicial system is askew and untrustworthy.

The infamous McDonald's "hot coffee" case is a perfect example.[45] In the "hot coffee" case, a senior citizen was awarded a substantial amount of money because she was not warned of the risk that

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[41]UFTA § 4, cmt. 5, 7A U.L.A. at 654. However, if the badges coalesce in the combination needed to prove constructive fraud, then fraud is "conclusively" presumed, "without regard to the actual intent of the parties." *Id.*

[42]"[T]he presence of fraud is to be determined by the particular facts surrounding a particular conveyance and not every conveyance of property by one against whom suit is pending will be deemed fraudulent." Orlando Light Bulb Serv., Inc. v. Laser Lighting & Elec. Supply, Inc., 523 So. 2d 740, 744 (Fla. Dist. Ct. App. 1988). *Accord* Jacksonville Bulls Football, Ltd. v. Blatt, 535 So. 2d 626, 629 (Fla. Dist. Ct. App. 1988) ("[T]he mere fact that suit is pending against a person, or that a person is indebted to another, does not in and of itself render fraudulent that person's conveyance of property.").

[43]*Stein*, 480 N.E.2d at 1124; *see also supra* note 40.

[44]UFTA § 4, cmt. 6, 7A U.L.A. at 654.

[45]Liebeck v. McDonald's Restaurants, P.T.S., Inc., No. CV-93-02419, 1995 WL 360309 (N.M. Dist. Ct. Aug. 28, 1994). *See also* Elizabeth Sherowski, *Hot Coffee, Cold Cash: Making the Most of Alternative Dispute Resolution in High-Stakes Personal Injury Lawsuits*, 11 OHIO ST. J. ON DISP. RESOL. 521 (1996) (discussing facts and outcome of *Liebeck* and using the case as an example of one in which the parties should have explored alternative dispute resolution techniques as an alternative to expensive litigation).

McDonald's hot coffee could scald her if spilled.[46] Many Americans viewed this result as absurd. The *McDonald's* case is not an isolated incident. The print and television media frequently report other cases that fuel the public perception that American litigation is devoid of common sense.

Worst of all, the public's perception is explicitly validated by judges and law school academics. For instance, Justice Richard Neely of the West Virginia Supreme Court, in an amazingly candid moment, stated,

> As long as I am allowed to redistribute wealth from out-of-state companies to injured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else's money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me.[47]

Likewise, most former torts students remember their professors saying that as between two innocent parties, society should put the burden of loss on the party most able to pay. Indeed, this redistributionist view has been accepted by the United States Supreme Court, which expressly stated in the context of a recent civil rights case: "Doctrines of tort law have changed significantly over the past century . . . . No longer is individual 'blameworthiness' the acid test of liability; the principle of equitable loss-spreading has joined fault as a factor in distributing the costs of official misconduct."[48]

Therefore, many people, particularly the wealthy, conclude that they and their families are at risk simply by virtue of living in contemporary American society. Americans believe their legal system is more concerned with redistributing wealth than with logic, common sense, culpability, or justice, and it is frequently hard to disagree with such conclusions.[49]

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[46]*Liebeck*, 1995 WL 360309, at *1.

[47]RICHARD NEELY, THE PRODUCT LIABILITY MESS: HOW BUSINESS CAN BE RESCUED FROM THE POLITICS OF STATE COURTS 4 (1988).

[48]Owen v. City of Independence, Mo., 445 U.S. 622, 657 (1980) (commenting in a decision regarding municipal liability under the Civil Rights Act, 42 U.S.C. § 1983 (1994)).

[49]*See, e.g.*, E. Marie Tucker Diveley, *Are Constitutional Challenges to Punitive Damages Still Available*, 62 DEF. COUNS. J. 27, 33-34 (1995) (observing that the dramatic increase in punitive damage awards in civil courts has shaken the public's confidence in the American judicial system).

A direct consequence of this prevailing sentiment is that many people look for ways to shelter their assets from the claims of unspecified creditors who might sue at a later date. This has led to an explosion of "asset protection planning" in recent years. Transferors place their assets into a myriad of shelters designed to protect assets from potential future lawsuits. Holding companies for family assets, including limited partnerships or limited liability companies,[50] trusts,[51] ERISA plans,[52] exempt property,[53] and offshore "asset protection trusts,"[54] have all

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[50]Limited liability companies (LLCs) are a relatively recent legislative creation that has swept the country in the past five to ten years. LLCs are a hybrid between a corporation and a general partnership. Assuming that certain formalities are observed, the members of the LLC will have the same limited liability advantages of stock ownership. At the same time, these entities are structured to allow the advantages of partnership "flow through" taxation, thus avoiding the burden of double taxation (i.e., tax on both corporate income and on dividends to shareholders) that is typically associated with corporations. LLCs are now legally available in virtually every state in the union. For a useful compendium of current LLC law, the reader is referred to J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE BY STATE GUIDE TO LAW AND PRACTICE (1994 & Supp. 1997). In the interests of disclosure, the author notes that he is not related to the Sullivan who wrote the cited LLC text.

[51]Trusts are a longstanding creature of common law and have been recognized in virtually every common law jurisdiction for centuries. A trust is not an entity, but instead,

> A trust . . . when not qualified by the word "charitable," "resulting" or "constructive," is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.

RESTATEMENT (SECOND) OF THE LAW OF TRUSTS § 2 (1959).

[52]*See infra* note 160.

[53]Exempt property is property owned by a debtor which is legally off limits to creditors. Exemptions are sometimes created by state constitutions and state or federal statutes. *See, e.g. In re* Johnson, 880 F.2d 78,79 (8th Cir. 1989) (explaining that the scope of the exception permitting debtors to exempt property from distribution to creditors is fixed by state law, but that the debtor's right to discharge is governed by federal law). Except in cases involving constitutional exemptions, the nature, scope and extent of exempt property laws is a matter of legislative discretion and the legislature's view of public policy. *See, e.g., In re* Clements, 194 B.R. 923, 925 (Bankr. M.D. Fla. 1996) (noting constitutional limits on legislative discretion to curtail homestead exemption); *In re* Miller, 188 B.R. 302, 308-09 (Bankr. M.D. Fla. 1995) (explaining that protection of homestead property is constitutionally guaranteed, but that annuities are governed by statute and, thus, subject to exceptions such as the exception relating to the fraudulent transfer of non-exempt property into exempt property). A certain class or type of property can be wholly off limits to creditors, or only partially off limits to creditors. The general purpose of exempt property statutes is to ensure that debtors and/or their families have certain minimal financial resources, thereby keeping debtors off the public dole and preventing them from becoming wards of the state. Public Health Trust of Dade County v. Lopez, 531 So. 2d 946, 948 (Fla. 1988) (finding the purpose of exemption is to allow the debtor to "live beyond the reach of financial misfortune and the demands of creditors"). Exemptions are thus seen as a benefit to the public at large, even if exemptions cause hardship to particular creditors. *See, e.g., In re* Johnson, 880 F.2d at 83 (quoting Cargill

become weapons in the arsenal of people trying to protect themselves and their hard earned wealth from litigation that might arise in the future. Most of these tools involve taking assets out of the client's name and transferring that property into the name of some other person or entity. At the same time, many of these transfers leave the transferor with some degree of use, benefit or control over the property in question. For instance, many transferors act as the general partner in family limited partnerships, thus retaining substantial control over property they contribute to the partnership. Likewise, many offshore trust statutes expressly or impliedly repeal the Statute of Elizabeth, either in whole or in part, and often include provisions allowing settlors the potential right to retain the use, benefit, and control of property settled into trust.[55]

The problem is that all such transfers are made with an intent to frustrate future litigants. Even if other motives (such as traditional estate and retirement planning) co-exist with the fear of litigation, no one can plausibly deny that asset protection planning is designed, at least in part, to shelter assets from future suitors. This plaintiff-protection motive conflicts with the constraints imposed by the literal terms of UFTA section 4(a)(1).[56] UFTA deems fraudulent any "transfer made . . . with actual intent to hinder, delay, or defraud any creditor of the debtor," even in cases where "the creditor's claim arose . . . after the transfer was made."[57] Under a literal reading of this statutory provision, all forms of asset protection planning are fraudulent and must fail unless there is a legal basis for believing that the terms of section 4(a)(1) are somehow limited in their scope. This conclusion could have additional force in cases involving transferors who have "retained possession or control" of the transferred property, because such retention is expressly itemized as

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v. Hedge, 375 N.W.2d 477, 479 (Minn. 1989) (other citations omitted) ("This 'wise and humane policy' is not just for the debtor's benefit, but is also 'in the interest of the state, whose welfare and prosperity so largely depend upon the growth and cultivation among its citizens . . . .'")); Frase v. Branch, 362 So. 2d 317, 318-19 (Fla. Dist. Ct. App. 1978) (stating that an exemption statute is liberally construed in favor of the debtor, "even at the sacrifice of just demands").

[54]*See* SPERO, *supra* note 1, ch. 7 (providing a general review of offshore and foreign trusts). *See also infra* notes 55, 164-67 (providing more detail on the protective features of these trusts).

[55]*See, e.g.*, The Cook Islands International Trust Act § 13C (1984), *cited in* SPERO, *supra* note 1, at D-17. The Cooks are an independent nation in the South Pacific and are a former dependency of New Zealand. An almost verbatim copy of the Cook Islands legislation has been adopted by the Caribbean jurisdiction of Nevis. *See* Nevis International Exempt Trust Ordinance § 24 (1994 as amended).

[56]UFTA § 4(a)(1), 7A U.L.A. 639, 652 (1984).

[57]*Id.*

one of UFTA's statutory badges of fraud.[58] These concerns raise a very fundamental question: Are asset protection shelters against future claims inherently fraudulent? Fortunately, they are not.

Section 4(a)(1) is subject to limits which are based on case law, UFTA's text, and the legislative intent as seen by the drafters' comments. It is well established under recognized legal theories that individuals may not strip themselves of assets in an intentional, reckless, or even negligent disregard of likely claimants.[59] Beyond this important limit, however, it is correct to state that planning to protect assets from future lawsuits is not inherently fraudulent but is actually perfectly legitimate. If transferors understand UFTA's limits and structure their plans around these boundaries, transferors will find that they still have ample rights to take many steps to protect their assets from future lawsuits.

III. EXCEPTIONS TO SECTION 4(a)(1) REGARDING FUTURE CREDITORS

A. *Not All Future Claimants Hold "Claims"*

UFTA's first important exception is found in the word "claim." Put simply, not all plaintiff's hold "claims," and those who lack "claims" cannot invoke UFTA.

1. The Timing Point Created by the Definitions

The first issue related to the word "claim" is an important definitional concern that creates a very significant timing issue. Under the statutory definition and related case law, the only persons protected by UFTA are those who have rights under the law existing at the time of transfer, i.e., today's law.[60] UFTA does not protect those whose claims are based on theories of liability that arise after the time of transfer.[61]

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[58] *Id.* § 4(b)(2), 7A U.L.A. at 653.

[59] *Id.* § 4(a)(2), 7A U.L.A. at 653 (regarding inadequate retention of assets); Schreyer v. Platt, 10 S. Ct. 579 (1890) (examining a transfer of property between a husband and a wife to see if they had intent to defraud creditors); *In re* Agricultural Research & Tech. Group, Inc., 916 F.2d 528, 536 (9th Cir. 1990) (improper to knowingly deplete a business to the detriment of unsecured creditors); Winchester v. Charter, 94 Mass. (12 Allen) 606, 611 (1866) (conveyance improper if "made with an intent to put the property, so that it could not be come at to secure debts by attachment or seizure, which the grantor at the time of the conveyance intended to contract, and which he did not intend to pay or had *reasonable ground to believe* that he might not be able to pay") (emphasis added).

[60] UFTA § 1(3)-(4), 7A U.L.A. at 644 (defining creditor as "a person who has a claim" and defining claim as a "right to payment," thus implying a present possibility).

[61] *Id.*

The prospective laws of tomorrow, and their potentially expanded liabilities, simply do not count for UFTA purposes. This, in turn, means that transferors who fear novel or expanded theories of liability may transfer assets away in order to frustrate subsequent litigants who might invoke liability theories that are not presently actionable.

This conclusion is necessarily based upon UFTA's language.[62] UFTA section 1(4) defines "creditor" as "a person who has a claim."[63] In turn, UFTA section 1(3) defines "claim" as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[64] The key point of the textual analysis is that not every demand for relief is a "claim" under UFTA.

The operative phrase in the definition is "right to payment." Unless the plaintiff has a legal "right," he does not hold a "claim" and, therefore, is not a "creditor." Granted, "claim" can be, and often is, broadly construed to encompass virtually every type of demand raised by a plaintiff, regardless of the legal theory employed.[65] While such broad

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[62]United States v. Turkette, 452 U.S. 576, 580 (1981) (quoting Consumer Prod. Safety Comm'n v. GTE Sylvania, 447 U.S. 102, 108 (1980)) ("In determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'"). *Accord* Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 254 (1992) (quoting Rubin v. United States, 449 U.S. 424, 430 (1981)) ("When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'"); Rhode Island v. Narragansett Indian Tribe, 19 F.3d 685, 699 (1st Cir. 1994), *cert. denied*, 513 U.S. 919 (1994) ("In the game of statutory interpretation, statutory language is the ultimate trump card."); Blackfeet Indian Tribe v. Montana Power Co., 838 F.2d 1055, 1058 (9th Cir. 1988) ("The starting point for an issue involving statutory construction is the language in the statute itself.").

[63]UFTA § 1(4), 7A U.L.A. at 644.

[64]*Id.* § 1(3), 7A U.L.A. at 644. Note that it is not necessary to have a judgment or a firm written debt instrument for a claimant to be a "creditor" under UFTA. Anybody who holds or asserts a claim is a "creditor," even if the claim is not yet reduced to judgment. Accordingly, the Commissioners have stated, "[T]he holder of an unliquidated tort claim or a contingent claim may be a creditor protected by this Act," *id.* § 1, cmt. 4, 7A U.L.A. at 647, while a state supreme court has held, "[A] tort claimant becomes a creditor . . . at the moment in which the cause of action accrues." Stein v. Brown, 480 N.E.2d 1121, 1124 (Ohio 1985).

[65]See, e.g., BLACK'S LAW DICTIONARY 224 (5th ed. 1979), which defines "claim" in several ways, including a simple "demand for money or property." See also the counterpart definition of "claim" under the Bankruptcy Code, 11 U.S.C. § 101(5) (1994) (defining "claim" as either: "(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured . . .; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment"), and cases construing "claim," such as *In re* Chateaugay Corp., 53 F.3d 478, 496-97 (2nd Cir. 1995) (stating that Congress intended "claim" to have "the 'broadest possible' scope"); *In re* Bennett, 175 B.R. 181, 183 (Bankr. E.D. Pa. 1994) (stating that "'claim' is to be interpreted broadly").

construction may be acceptable in common parlance, it is inappropriate under UFTA. Moreover, this definitional limit is fundamental because only "creditors" may invoke UFTA's remedies.[66]

At the same time, UFTA also defines "debt" as a "liability on a claim" and a "debtor" as someone "who is liable on a claim."[67] Significantly, only "debtors" can make fraudulent transfers.[68] If a transferor is not liable, then he is not a "debtor" and may disregard UFTA. In summary, the only people who are "creditors" are those who have a "right" to a transferor's money, and the only persons who are restrained by UFTA are "debtors" who are "liable on a claim."

Rights and liabilities are, at least in part, a question of law. If the law does not recognize certain causes of action or theories of liability, then the holder of a noncognizable claim is not a "creditor" protected by UFTA, and, conversely, the transferor is not a "debtor" owing a "debt" at the time of transfer. Hence, a person who holds or might hold a novel, untested or disfavored claim simply does not have standing under UFTA.[69] As defense counsel would rightly argue, suits based on such

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However, "the definition of claim is not without limits." *Id.*

[66]UFTA § (4)(a)(1) only applies to transfers made with "intent to hinder, delay, or defraud a[ ] creditor." 7A U.L.A. at 652. *See also* § 4(a), 7A U.L.A. at 652 ("A transfer is fraudulent as to a creditor . . . ."); *id.* §§ 5(a), (b), 7A U.L.A. at 657 ("A transfer . . . is fraudulent as to a creditor . . . ."); *id.* § 7, 7A U.L.A. at 660 (enumerating remedies available to a "creditor"); *id.* § 8(b), 7A U.L.A. at 662 ("the creditor may recover judgment").

Case law further supports this interpretation. *See, e.g.*, Allard v. DeLorean, 884 F.2d 464, 466 (9th Cir. 1989) ("A plaintiff is not entitled to the remedy of setting aside a fraudulent conveyance unless he has shown that he is a creditor.") Hence, "[t]he rule is recognized that where there is no creditor there is no fraud. The motive with which a conveyance is made and the fears by which it is prompted are of no importance unless there are creditors to be protected." Stout v. Clayton, 674 S.W.2d 821, 828 (Tex. Ct. App. 1984). *See also In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 391 (Bankr. S.D. Fla. 1991); Gilbert v. Armstrong Oil Co., Inc., 561 So. 2d 1078, 1082 (Ala. 1990); Eurovest, Ltd. v. Segall, 528 So. 2d 482, 483-84 (Fla. Dist. Ct. App. 1988), all of which require "a creditor to be defrauded" as one of three elements to a fraudulent transfers claim.

[67]UFTA §§ 1(5)-(6), 7A U.L.A. at 644. Further, UFTA's "definition of 'debt' is derived from § 101(11) of the Bankruptcy Code." *Id.* § 1, cmt. 5, 7A U.L.A. at 647. The legislative history to the Bankruptcy Code provides further definitional insight. The Senate Judiciary Committee's report, Senate Report No. 95-989, states, "'Debt' is defined . . . as a liability on a claim. The terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor." Bankruptcy Reform Act of 1978, S. REP. NO. 95-989, at 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809.

[68]UFTA § 4(a), 7A U.L.A. at 652 ("A transfer made . . . by a *debtor* is fraudulent . . . .") (emphasis added); *id.* § 5(a), 7A U.L.A. at 657 (using identical language).

[69]"Standing has been called one of 'the most amorphous [concepts] in the . . . law.'" Flast v. Cohen, 392 U.S. 83, 99 (1968) (alteration in original) (referring to "public law" questions). "In essence the question of standing is whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues." Warth v. Seldin, 422 U.S. 490,

disfavored theories should be dismissed for "failure to state a claim upon which relief can be granted."[70]

More importantly, conduct that is legal today does not give rise to a "claim" that can be retroactively asserted if the law is subsequently changed. The view that today's law, and not tomorrow's, establishes the existence of a claim is supported by bankruptcy case law. This case law is especially instructive because the definitions of "claim" and "creditor" under the Bankruptcy Code are strikingly similar to the definitions used under UFTA.[71] Under this case law, "a right to payment means nothing more or less than an enforceable obligation."[72] Furthermore, the "enforceable obligation" must exist at the time the allegedly improper activity occurred.[73] Consequently, unless the law at the time of transfer creates an enforceable obligation, a claim does not exist.

For instance, the Second Circuit's recent analysis of the term "claim" in *In re Chateaugay Corp.* makes it very clear that tomorrow's law does not count.[74] In that case, debtor LTV Steel filed for bankruptcy in 1986.[75] In late 1992, Congress enacted the Coal Act, which became effective on February 1, 1993 and which subjected the company to extensive pension and benefits obligations.[76] The Second Circuit reviewed the impact of LTV Steel's bankruptcy upon claims raised by its retirees under the Coal Act and concluded that the retirees' demands under the Coal Act had not yet matured to the level of "claims" as of the

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498 (1975). For UFTA purposes, a suitor who is not a creditor is not entitled to invoke UFTA's remedies and therefore has no standing because, to borrow from *Warth*, he is not "entitled to have the court decide the merits of the dispute." *Id.* An example is *Allard*, 884 F.2d at 466, in which the court stated:

> A plaintiff is not entitled to the remedy of setting aside a fraudulent conveyance unless he has shown that he is a creditor. . . . Here, Allard is attempting to set aside DeLorean's transfer of the Pauma Valley property to Weitzman. . . . The parties agree that Allard is no longer a creditor in this action . . . . Because Allard is not entitled to the remedy of setting aside DeLorean's conveyance to Weitzman as fraudulent, . . . he does not have an interest in the outcome of this appeal.

Id. (citation omitted). *See also* Wantulok v. Wantulok, 214 P.2d 477, 483 (Wyo. 1950) (noting the majority rule that there must be creditors to defraud).

[70]FED. R. CIV. P. 12(b)(6).

[71]*See* 11 U.S.C. §§ 101(5), 101(10) (1994).

[72]*See In re* Irizarry, 171 B.R. 874, 878 (B.A.P. 9th Cir. 1994).

[73]*In re* Chateaugay Corp., 53 F.3d 478, 497 (2d Cir. 1995) ("[A] valid bankruptcy claim depends on whether [ ] that right [to payment] arose before the filing of the petition.").

[74]*Id.* at 496-97.

[75]*Id.* at 484.

[76]*Id.* at 486 (regarding effective date of the Coal Act).

date of LTV Steel's bankruptcy.[77] In so holding, the court set forth a two-prong test: "However broadly 'claim' is understood, it is clear that the existence of a valid bankruptcy claim depends on (1) whether the claimant possessed a right to payment, and (2) whether that right arose before the filing of the petition."[78] The second prong, thus, expressly focuses on timing issues. The court also noted that a claim is based on "a relationship recognized in . . . the law of contracts or torts."[79] This implies that unrecognized theories of liability will not give rise to a "claim" under UFTA.

Even more explicitly, the Second Circuit invoked case law from the Third Circuit and stated:

> Our conclusion is supported by the courts' treatment of [Comprehensive Environmental Response, Compensation & Liability Act] liability in similar bankruptcy cases. In *Matter of Penn Central Transp. Co.*, . . . the Third Circuit *refused to find that a clean-up claim under CERCLA could exist prior to the enactment of the statute, even though the claim admittedly was based on pre-petition activities. . . .* The mere fact that LTV's retirees were employed by LTV pre-petition does not, in and of itself, render pre-petition all claims arising thereafter that may have any nexus to such employment. We agree with the district court that *the Combined Fund's "claims" under the Coal Act* in this case "were not in any sense 'contingent' or 'unmatured' . . . they *simply did not exist.*" . . . "[W]here there is no legal relationship defined at the time of petition," that is, *where the statute imposing the liability has not been enacted, "it would be impossible to find even the remotest 'right to payment.'"*[80]

Accordingly, a claim does not exist until the law giving rise to that claim is in place. Transferors are therefore entitled to frustrate persons who might be future plaintiffs based on new, expanded liability laws because

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[77] *In re Chateaugay Corp.*, 53 F.3d at 497.

[78] *Id.*

[79] *Id.*

[80] *Id.* (emphasis added) (citations omitted) (alteration in original) (referring to Comprehensive Environmental Response, Compensation & Liability Act, 42 U.S.C. § 9601 (1994); *In re* Penn Cent. Transp. Co., 944 F.2d 164 (3d Cir. 1991).

such would-be plaintiffs are not yet UFTA creditors, and indeed may never become creditors within the meaning of the Act.

This timing point is of great practical significance to planners and clients alike. Many people shelter assets because they fear that courts or legislatures may radically rewrite the law and greatly increase liability exposure in an unpredictable and ever expanding fashion. Moreover, this fear is grounded in historical reality. The eight decades since *MacPherson v. Buick Motor Co.*[81] have seen a continuing judicial expansion of product liability doctrines. Likewise, Congress is continually expanding personal liability by enacting statutes like the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)[82] and the Americans With Disabilities Act (ADA).[83] Clients, therefore, have ample reason to fear that the law will someday change and suddenly make them liable for acts or omissions that were hitherto legal. Worse still, no one can predict exactly how or when such changes will occur. Clients seek shelters to protect against this uncertainty. Fortunately, clients motivated by such concerns are free to make transfers. The vague, undefined, and speculative future plaintiff who might invoke an equally uncertain future change in the law is not a "creditor" because that plaintiff does not have a "claim" that will give rise to a "liability" at the time of transfer. Consequently, because UFTA section 4(a)(1) only applies to transfers made with "intent to hinder, delay, or defraud a[ ] creditor," this provision of the act simply does not benefit such a plaintiff.[84]

Therefore, the definitional limits of UFTA's text become exceedingly significant. They provide a solution to the superficially insoluble problem of complying with UFTA when making transfers in contemplation of future plaintiffs asserting bizarre legal claims. UFTA's definitions and related cases show that many future potential plaintiffs simply are not within the class protected by UFTA because they do not have a legal "right" to payment and, hence, are not "creditors."

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[81] 111 N.E. 1050 (N.Y. 1916).

[82] For CERCLA, see 42 U.S.C. § 9601 (1994). CERCLA § 107(a) liability is so broad that it has prompted one court to write: "CERCLA liability has been described as 'a black hole that indiscriminately devours all who come near it.' For example, CERCLA has been read as a strict liability statute. It has been applied retroactively. . . . And it has corroded the corporate veil." Long Beach Unified Sch. Dist. v. Godwin Living Trust, 32 F.3d 1364, 1366 (9th Cir. 1994) (citations omitted).

[83] 42 U.S.C. §§ 12101-12213 (1994). *See generally* Brian Doherty, *Unreasonable Accommodation*, 27 REASON MAGAZINE, Aug.-Sept. 1995, at 18 (illustrating the ADA's broad sweep).

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

2. The Intent Issue

The notion of claimants without "claims" raises an interesting intent issue. Since prospective suitors who do not presently hold "claims" are not "creditors" under UFTA, they are not members of UFTA's protected class, even if post-transfer legislation or judicial opinions would make them "claim" holders at a later date. Clients may, therefore, make transfers infused with a fulsome and unabashed intent to frustrate the prospective claims of such potential suitors. This represents a sharp contrast to future suitors who hold "claims" that are recognized by today's law. Transfers made with intent to hinder, delay, or defraud this latter group of future suitors are impermissible (subject to other concerns addressed below) because those suitors are "creditors" within the meaning of the Act. Thus, UFTA permits intentional hindrances that afflict one group of suitors but prohibits transfers intended to injure another class of suitors. This means that the right to frustrate one group of suitors is not a license to make transfers with impunity. A transferor cannot use his right to frustrate claimants without "claims" as a pretext to injure legitimate creditors.

The distinction between permissible and impermissible intent may create significant openings for clients and planners, but it could also create nettlesome fact questions for judges and juries. Creditors and their attorneys will undoubtedly complain that distinguishing between permissible and impermissible intent will encourage some transferors to rationalize fraudulent conduct.[85] Courts will need to guard against such subterfuges, and juries will need to be carefully instructed about the differences between permissible and impermissible conduct. Despite these precautions, erroneous results may arise, as a fraudulent transferor might successfully argue that he was only acting with permissible intent, and did not intend to defraud UFTA-protected "creditors." Indeed, asset protection planners and their clients would perhaps be the group most willing to concede the possibility of error by the fact finder, as this group is inherently skeptical of the system's ability to dispense proper justice. The risk of error, however, does not obviate the need to assess intent. Moreover, judges and juries are routinely charged with the duty of sifting proper intentions from wrongful ones, and there is no reason why UFTA cases should be treated differently. Unless the law is willing to dispense

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[85]Undoubtedly, there is merit to this concern. For instance, one can easily envision a negligent uninsured motorist suddenly transferring assets to a spouse for less than REV the day after he hit someone and then profess that he made such transfers because he feared prospective expansions in liability laws.

with intent as an element of an offense and, instead, look solely to the effect of certain conduct, then alternative-intent defenses must be considered fair game for all defendants, including UFTA defendants.[86]

3. The "Attenuated" Demand

The term "claim" is also potentially circumscribed by case law dealing with "attenuated" relationships between past events and future claims, as shown by *In re Piper Aircraft Corp.*[87]

In *Piper*, the Piper corporation filed for Chapter 11 protection under the Bankruptcy Code.[88] Part of any Chapter 11 reorganization plan[89] entails recognizing valid claims[90] and then making allowance for payment of those claims (usually for some number of pennies on the dollar) as part of the confirmed plan of reorganization.[91] It is in the debtor's best interest to minimize the number of allowed claims, because fewer claims means a reduced dollar volume of debts, which makes it easier to reorganize and secure approval of a plan. Likewise, it is in the interest of any creditor to eliminate the claims of other putative claim-holders because fewer claimants means a higher payout rate for the remaining claim-holders. Consequently, the debtor and those holding valid claims have a mutual interest in defeating questionable claims. In *Piper,* the questionable claims were those asserted by would-be future creditors.[92]

As part of the *Piper* case, the Bankruptcy Court appointed a "Legal Representative" to assert the interests of a class named the "Piper Future Claimants."[93] The class included "[a]ll persons, whether known or unknown, born or unborn" who might sue *after* the confirmation of the plan, for events occurring "in whole or in part" after confirmation, that

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[86]Of course, plaintiffs who might decry this alternative-intent argument find themselves in an ironic situation. Plaintiffs would be implicitly doubting the ability of juries to distinguish between legitimate cases of alternative intent and cases involving mere pretexts. However, it is the plaintiffs' bar that routinely extolls the virtues of the jury system when jurors return outrageous verdicts.

For additional cases and issues regarding the importance of alternative intent, see *infra* notes 240, 269.

[87]168 B.R. 434 (Bankr. S.D. Fla. 1994), *aff'd sub nom.* Epstein v. Official Comm. of Unsecured Creditors of Estate of Piper Aircraft Corp., 58 F.3d 1573 (11th Cir. 1995).

[88]*Id.* at 435-36.

[89]*See* 11 U.S.C. §§ 1101-1171 (1994).

[90]*See, e.g., id.* §§ 1111, 1122.

[91]*See, e.g., id.* §§ 1123, 1124, 1126, 1129, 1142.

[92]*In re Piper Aircraft Corp.*, 168 B.R. at 436.

[93]*Id.*

were somehow related to Piper's pre-confirmation sale, design, or manufacture of aircraft or aircraft parts.[94] The Legal Representative filed a claim on behalf of his constituents in the estimated amount of $100 million, and Piper and other creditors predictably objected to this claim.[95]

Ultimately, both the bankruptcy court and, on appeal, the district court and court of appeals, found that the Piper Future Claimants did not have a "claim."[96] In reaching this conclusion, the courts employed the "Prepetition Relationship Test," which considered various factors in the relation between Piper and the Future Claimants, including "'contact, exposure, impact, or privity, between the debtor's prepetition conduct and the claimant.'"[97] The district court found that, on the facts of the case, the relationship between the prepetition acts of Piper and the possible future claims was "simply . . . too attenuated."[98] The district court was particularly troubled by the fact that some of the Future Claimants were "unidentified and unidentifiable," that some had "suffered absolutely no injuries prepetition," and that others were "yet unborn and . . . by definition [could] have no prepetition contact with Piper."[99] Instead, the district court held that, "for a 'claim' to exist, there must be some way to connect the future claims to the debtor today . . . such that it can be fairly said that Piper's obligations to the Future Claimants are sufficiently rooted in the present."[100]

Piper's holding imposes additional limits to the word "claim." *Piper* requires some meaningful link between alleged future injuries and past or present misconduct. As specifically applied in *Piper*, the court ruled that a "claim" did not exist because the debtor had no prepetition dealings with the Piper Future Claimants.[101] However, *Piper* can also be read more broadly.

In general, *Piper* can be interpreted as denying "claim" holder status to any prospectively injured party whose relation to the alleged

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[94] *Id.*

[95] *Id.*

[96] Epstein v. Official Comm. of Unsecured Creditors of Estate of Piper Aircraft Corp., 58 F.3d 1573 (11th Cir. 1995)

[97] *In re Piper Aircraft Corp.*, 168 B.R. at 439 (quoting *In re* Piper Aircraft Corp., 162 B.R. 619, 627 (Bankr. S.D. Fla. 1994)). Note, however, that this list of factors was expressly held to be nonexhaustive. *Id.* at 440. Further, on appeal, the Eleventh Circuit slightly modified the test by allowing claims for pre-confirmation injuries, as opposed to prepetition injuries, arising from prepetition conduct. *Epstein*, 58 F.3d at 1577. Otherwise, the court of appeals wholly endorsed the district court's analysis.

[98] *In re Piper Aircraft Corp.*, 168 B.R. at 440.

[99] *Id.*

[100] *Id.* at 439.

[101] *Id.*

debtor is too remote. This broader reading is little more than restating traditional negligence law, which routinely holds that some plaintiffs must lose because the defendants do not owe them any duty or because the plaintiffs are beyond an amorphous zone of danger.[102] Thus, the holder of a demand deemed too attenuated is not a "creditor" for UFTA purposes.

Admittedly, the broad reading of *Piper* has limits. To begin with, *Piper* interpreted "claim" in the limited context of determining who was eligible to share in distributions made pursuant to a confirmed plan of reorganization.[103] Whether *Piper's* interpretation applies in other contexts remains to be seen.

Next, bankruptcy courts are notoriously pragmatic. Recognizing tens of millions of dollars of claims of unknown, unborn persons who had no contact with the debtor and who have not yet even been injured "would likely create very real and formidable practical and logistical problems" in processing a bankruptcy.[104] Accordingly, that prospect alone would be enough to induce narrow interpretations of "claim."

Further, the district court repeatedly confined its holding to the facts of that particular case.[105] The court also carefully noted that construing "claim" can have effects that cascade throughout the Bankruptcy Code, and that any attempt to definitively construe "claim" is, in the *Piper* court's opinion, best left to the legislature.[106]

Most significantly, *Piper* did not involve a fraudulent transfer claim. This is important because a bankruptcy could entail the following fact pattern: (1) a transfer, (2) a post-transfer incident giving rise to creditor claims, (3) the filing of a bankruptcy. In this scenario, a future creditor would have an identified claim that existed on the date of the bankruptcy petition which might obviate some of the concerns expressed by the *Piper* court. Because of all these considerations, the precedential value of *Piper* in a planning situation may be reduced.

Nonetheless, *Piper* still has an impact. The Bankruptcy Code's definition of "claim" sets forth a uniform definition that applies in all parts of the Code and that does not distinguish between the types of

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[102]*See, e.g.*, Palsgraf v. Long Island R.R., 162 N.E. 99, 100 (N.Y. 1928) (explaining the zone of danger concept in negligence actions). The specific facts that created Palsgraf's "zone of danger" are discussed *infra* note 110.

[103]*In re Piper Aircraft Corp.*, 168 B.R. at 436.

[104]*Id.* at 440.

[105]*See, e.g., id.* (referring to "specific facts of this case"); *id.* at 439-40 n.11 (referring also to "circumstances that exist in this case").

[106]*Id.* at 439-40 n.11.

issues presented.[107] Accordingly, *Piper*'s "too attenuated" analysis of the word "claim" should not be limited to plan confirmation matters but should also have equal applicability to fraudulent transfer suits brought under the Code.[108] Further, since UFTA and its definitions are

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[107]11 U.S.C. § 101(5)(A)-(B) (1994).

[108]See 11 U.S.C. § 101(5) (1994), for the definition of "claim," which is uniform and which is not qualifiedly applied to any Bankruptcy Code section. See also Patterson v. Shumate, 504 U.S. 753, 758-59 n.2 (1992) (quoting Morrison-Knudsen Constr. Co. v. Director, Office of Workers' Compensation Programs, 461 U.S. 624, 633 (1983)), in which the Supreme Court, in construing another section of the Bankruptcy Code, stated that "'a word is presumed to have the same meaning in all subsections of the same statute.'" *Id.*). Consequently, it is proper to conclude that *Piper*'s construction of "claim" would apply to the Code's fraudulent transfers provisions.

While most courts would probably agree that "claim" should be given a uniform construction throughout the Bankruptcy Code, there is room for some potentially sharp debate over just what that construction should be. As *Piper* noted, the Prepetition Relationship Test is not universally accepted, and other courts have adopted tests known as the "Conduct Test" and the "Accrued State Law Theory." *In re Piper Aircraft Corp.*, 168 B.R. at 437. However, as *Piper* also noted, these other theories suffer from drawbacks. *Id.* at 437 n.3.

Under the Conduct Test, "a right to payment arises 'at the moment when acts giving rise to the alleged liability are performed.'" *Id.* (quoting *In re* Waterman S.S. Corp., 141 B.R. 552, 556 (Bankr. S.D.N.Y. 1992). However, the Conduct Test cannot be a correct reading of the law. The Supreme Court has expressly said that a claim consists of an "enforceable obligation." Pennsylvania Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 559 (1990). In contrast, the Conduct Test redefines "claim" so that the term encompasses mere allegations of liability, which may or may not prove to be enforceable obligations. This is contrary to the Supreme Court's more limited interpretation, which alone is sufficient grounds to reject the Conduct Test. Moreover, the conduct in question may not ever result in harm. Therefore, it cannot be confidently said that the relevant acts or omissions would ever result in injuries requiring compensation. *Cf. In re* Piper Aircraft Corp., 162 B.R. 619, 625 (Bankr. S.D. Fla. 1994) (noting that "under the Conduct Test, everyone in the world would hold a claim against Piper simply by virtue of their potential future exposure to any plane in the existing fleet"). Stated differently, the Conduct Test could make claim holders out of uninjured, never-to-be-injured persons who will never need relief. The Conduct Test therefore creates an overly broad definition of "claim."

The Accrued State Law Theory, which is recognized only in the Third Circuit, pursuant to that court's holding in *In re* M. Frenville Co., 744 F.2d 332 (3d Cir. 1984), goes to the other extreme and reads "claim" too narrowly. Under *Frenville*, a "claim" does not exist until a cause of action has accrued under state law. Thus, the claim does not exist until suit can be filed, even if the accrual date is after the date on which the allegedly improper conduct has occurred. *Id.* at 337. Thus, in *Frenville*, a creditor was held not to have a "claim" for common law contribution and indemnity until after a bankruptcy petition was filed, even though the relevant facts occurred prepetition. *Id.* As a result, the automatic stay provisions of 11 U.S.C. § 362 (1994), which generally bar nonbankruptcy suits against the debtor on prepetition claims but which usually permit such suits on postpetition claims, did not bar a contribution and indemnity suit against the debtors because the "claim" did not exist for automatic stay purposes until after the petition date. *In re M. Frenville Co.*, 744 F.2d at 337. The court reasoned that a company referred to as A&B had been sued in New York state court for allegedly aiding the bankrupt debtors, the Frenvilles, in committing acts that injured the state court plaintiffs. *Id.*

modelled on the Code, *Piper's* approach should be persuasive when construing "claim" under state law versions of UFTA.[109] Moreover, applying *Piper* in an UFTA setting makes good sense. Persons with no contact, exposure, impact, or privity will have a difficult time showing that they have any rights against a transferor in connection with the underlying claims that give rise to the alleged debt. This, in turn, gives asset planners leeway to protect against *Palsgraf*-like scenarios.[110]

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at 333. The allegedly harmful conduct was prepetition, but the New York suit against A&B was filed postpetition. *Id.* at 337. As part of the New York suit, A&B wanted to sue the Frenvilles for contribution and indemnity in connection with any liability A&B might have had to the plaintiffs. *Id.* at 333-34. Under controlling New York procedural law, A&B's right to sue the Frenvilles for contribution and indemnity did not accrue until A&B was itself sued. *Id.* at 337. Consequently, A&B's cause of action for contribution and indemnity did not exist as a "claim" until after the petition date, meaning that the automatic stay did not apply because the claim was postpetition. *Id.* *Frenville* thus recognized the claim's existence, but substantially delayed the time of recognition, despite the pre-existing nature of the underlying facts. *Frenville*'s interpretation has properly been criticized as too confining and limited for various reasons, including the fact that its logic might prevent debtors from scheduling such contribution and indemnity claims as debts subject to potential discharge in bankruptcy. *In re Piper Aircraft Corp.*, 168 B.R. at 437 n.3.

The Prepetition Relationship Test seems a proper compromise between the two extremes staked out by the Conduct Test and *Frenville's* Accrued State Law Theory. The Prepetition Relationship Test links actual prepetition conduct to actual prepetition harm and does not jump into the realm of speculation about possible future injuries (in contrast to the Conduct Test), and does not allow technical rules of procedure and pleading to obscure actual liabilities (avoiding the pitfalls of *Frenville*). Accordingly, the Prepetition Relationship Test is a well reasoned approach to delineating the meaning of "claim." Moreover, because this definition applies to all sections of the Code, see *Patterson*, 504 U.S. at 758-59 n.2, the Prepetition Relationship approach should also be used in construing "claim" for fraudulent transfers purposes.

[109]UFTA is modelled substantially upon 11 U.S.C. § 548(a) (1994), which is the general fraudulent transfers provision conferred on bankruptcy trustees seeking to avoid transfers. Uniformity of law urges similar constructions so that identical state and federal statutes avoid disparate results.

[110]*Cf.* Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478, 490 (1988), *quoted in supra* note 4 (regarding lessened Constitutional protection for "conjectural" creditors); *see* Di Cosala v. Kay, 450 A.2d 508, 517 (N.J. 1982) (discussing reasonable foreseeability and the "zone of risk"); Palsgraf v. Long Island R.R., 162 N.E. 99 (N.Y. 1928) (regarding unusual fact patterns).

For those who may not remember the classic *Palsgraf* case from first-year torts class, Mrs. Palsgraf was standing at one end of a train platform when a passenger from another train, at the other end of the platform, leapt into a moving train. *Id.* He was assisted in his leap by railroad employees. *Id.* As a result of these events, the leaper dropped a package he was carrying, which struck the tracks. *Id.* The package contained fireworks, which exploded upon impact. *Id.* The force of the explosion caused a scale at the other end of the platform to fall on Mrs. Palsgraf, thereby injuring her and prompting her to sue the railroad. *Id.* The court found that this bizarre chain of events did not result in liability for the railroad. *Id.* at 101.

This is not to say that planners should ignore the likelihood or possibility of reasonably foreseeable claims. For instance, it is statistically probable that many doctors will be sued for malpractice at some point in their careers. Because of this risk, doctors purchase malpractice insurance. But even a highly insured doctor may still be concerned that some bizarre chain of events could lead to "attenuated" assertions of liability that would exceed insurance limits. An asset protection planner for the doctor can legitimately seize upon *Piper* as legal justification for transfers made to shelter wealth from such bizarre suits because under *Piper*, a plaintiff with that type of a suit does not have a "claim."[111]

This conclusion dovetails nicely with the "rule of reason" approach, which obliges transferors to account for reasonably foreseeable future claims but not for unforeseeable suits or judgments. This conclusion also dovetails with the right of transferors to discount potential risks to reflect the likelihood of their occurrence. Taken together, the "rule of reason," risk discounting, and *Piper* relieve clients of any duty to make their assets available to satisfy the bizarre, outrageous, or quirky results that have prompted so much planning activity in the first place.[112]

4. Conclusion: "Claim" is Not All Encompassing

Considerations involving *Piper* and the timing issue allow planners to draw some very important bottom line conclusions. Most important

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[111] *In re Piper Aircraft Corp.*, 168 B.R. at 436.

[112] *Piper* also comports with other case law, such as Leopold v. Tuttle, 549 A.2d 151 (Pa. Super. Ct. 1988). The *Leopold* court said that a "future creditor" is someone who asserts claims that are "reasonably foreseen as arising in the immediate future." *Id.* at 154. "In short, a 'future creditor' does not exist unless a conveying party can reasonably foresee incurring the costs of a claim or judgment at the time of the conveyance." *Id.* (citations omitted). Since an "attenuated demand," as in *Piper*, will almost always be a claim that the transferor cannot "reasonably foresee" at the time of transfer, *Piper* harmonizes with other case law.

Similarly, in Winchester v. Charter, 94 Mass. (12 Allen) 606 (1866), the court denounced transfers made to hinder or delay future creditors, but only if "the conveyance was made with an intent to put the property, so that it could not be come at to secure debts by attachment or seizure, which the grantor at the time of the conveyance intended to contract, and which he did not intend to pay or had *reasonable ground to believe* that he might not be able to pay." *Id.* at 611 (emphasis added). In other words, if the transferor set out to intentionally overextend himself, or had reasonable grounds to believe that he might overextend himself, then future creditors injured by such overextension would have relief. Hence, under *Winchester*, and assuming *arguendo* that a transferor did not intend to overextend himself, a future creditor would once again be limited to relief in only those circumstances where the creditor's needs were reasonably foreseeable at the time of transfer. *Accord* Schreyer v. Platt, 10 S. Ct. 579, 581-82 (1890).

is that not all suitors hold "claims," and it is permissible to make transfers to protect against suits that would not presently amount to "claims." Based on these conclusions alone, it becomes apparent that UFTA does not even begin to raise any type of absolute bar to asset protection planning.

B. *The Factual Question: Intent and the Long Range Solvency Calculation*

1. Introduction: The Long Range Solvency Calculation

The preceding review of purely legal issues does not end the inquiry into UFTA's limits. There is also the key factual question of a transferor's intent. A very important corollary question is what, if anything, can be inferred from the transferor's financial planning activities?

Planners and their transferor clients have three basic planning options, two of which are conceptual extremes. The first extreme is to transfer nothing. Under these circumstances, the lack of a transfer eliminates concern over fraudulent transfers. Of course, this also means that nothing is sheltered, thus limiting the attractiveness of the first alternative.

The other extreme is to seek shelter for all assets, regardless of potential claims by present or future creditors. This indiscriminate and wholesale approach may be viable in some circumstances, but it is more often likely to be taken as a sign that the transferor acted with reckless or intentional disregard for creditor's rights.[113]

The intermediate third approach is to place only a portion of the client's assets into a protective structure. The difficult question under this approach is what percentage of assets can be lawfully sheltered. There is no "bright line rule" established by statute or case law, and therefore each situation must be examined on the facts and circumstances of a client's unique position. Nonetheless, a general principle can be stated: Transferors should shelter only those assets remaining after making allowance for present creditors and reasonably foreseeable future creditors. Transferors who follow this principle can show that they tried

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[113] *Cf.* UFTA § 4(b)(5), 7A U.L.A. 639, 653 (1984) (transfers of "substantially all the debtor's assets" may be an indicia of intent) *with id.* § 4, cmt. 5, 7A U.L.A. at 654 (the existence of indicia of intent does not create a binding presumption of intent). The entire question of indicia of fraudulent intent is discussed in detail in connection with the "badges of fraud." *See supra* note 36.

to create a financial reserve for the sake of creditors, which will, in turn, enable them to legitimately argue that their asset protection transfers were not intended to injure legitimate claimants. Stated differently, proof of responsible planning can be a powerful argument against future creditors who subsequently claim that certain transfers are tainted with fraudulent intent.

This "financial reserve" approach can be formulaically stated as follows:

	Present Assets
+	Reasonably Foreseeable Future Assets
-	Present Debts
-	Reasonably Foreseeable Future Debts
=	Net Surplus or Deficit

The above formula can be thought of as a type of Long-Range Solvency Calculation (LRSC). Potential transferors who use the LRSC and then make transfers only from a surplus are adhering to UFTA's stated goal, which is to protect unsecured and undersecured creditors.[114] To create a surplus under the LRSC, a debtor must retain enough assets in his name to avoid prejudicing his unsecured and undersecured creditors. In the simplest of terms, a debtor must ensure that his assets match or exceed his liabilities. This requires identifying and defining a transferor's present assets and present liabilities, and also entails consideration of future assets and liabilities. After all, UFTA confers rights upon future creditors, and therefore these possible liabilities, and the future assets that might satisfy those liabilities, cannot be ignored.

Admittedly, this approach may raise difficult factual issues in identifying and appraising particular assets or liabilities: Not all property is of definite or known value, and what is reasonable is often open to legitimate debate. Likewise, the LRSC is a balance sheet approach, and,

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[114]"[T]he purpose of the Act [is] to protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors." UFTA § 3, cmt. 2, 7A U.L.A. at 650-51; *accord id.* § 1, cmt. 3, 7A U.L.A. at 646. However, as noted above in connection with the statutory definition of "claim," the term "creditors" does not include persons asserting outlandish or novel theories of liability. *See supra* notes 64, 67. Hence, a prospective transferor can exclude such litigants from her calculations under the LRSC. And, if there is a surplus, then a transferor may make transfers from the surplus to protect herself from such novel claims without prejudicing the rights of real creditors who are protected under UFTA.

The "reasonableness" element of the LRSC is based on various statutory provisions employing terms such as "fair valuation" and the adjective reasonable or its derivatives. *See infra* Part III.B.5.

as such, ignores timing issues regarding cash flow and the transferor's ability to pay his debts when they come due. Many persons with positive balance sheets have solvency problems due to illiquidity, and UFTA recognizes this concern at various points.[115] However, the LRSC and its formula still illustrate an important point. A transferor who uses the LRSC has taken steps to protect any creditor that might be reasonably expected.

Debtors who adhere to the LRSC will limit their dispositions to their surplus assets. The inevitable mathematical implication is that they have retained enough assets on their balance sheet to cover the claims of their creditors. Under these circumstances, it is difficult to see how a future plaintiff can prove fraudulent intent and actual fraud under section 4(a)(1). Far from injuring his unsecured and undersecured creditors, the transferor acted responsibly and with an intent to protect legitimate creditors.[116]

This conclusion is bolstered if the transferor refines his LRSC to account for two further exigencies. First, the transferor must bear in mind the need to maintain adequate cash flow in order to pay his debts when due, thereby avoiding cash flow insolvency as well as balance sheet

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[115]For instance, an element of constructive fraud under UFTA § 4(a)(2)(ii) is a transfer that leaves a debtor with "debts beyond his [or her] ability to pay as they became due." 7A U.L.A. at 653 (brackets in original). Likewise, in the definition of solvency, UFTA § 2(b) legally presumes that a debtor is insolvent if she is not paying bills as they come due. 7A U.L.A. at 648. *See also id.* § 2, cmt. 2, 7A U.L.A. at 648-49. Hence, a debtor can be insolvent on both a cash flow and a balance sheet basis.

As an aside, note that a debtor can rebut the presumption of insolvency arising from a failure to pay bills when due. The Commissioners expressly state, "Section 2(b) establishes a rebuttable presumption of insolvency." *Id.*, 7A U.L.A. at 648. Moreover, UFTA recognizes that simple nonpayment is not necessarily the same as failing to pay bills when due.

> In determining whether a debtor is paying its debts generally as they become due, the court should look at more than the amount and due dates of the indebtedness. The court should also take into account such factors as the number of the debtor's debts, the proportion of those debts not being paid, the duration of the nonpayment, and the existence of bona fide disputes or other special circumstances alleged to constitute an explanation for the stoppage of payments. The court's determination may be affected by a consideration of the debtor's payment practices prior to the period of alleged nonpayment and the payment practices of the trade or industry in which the debtor is engaged.

Id., 7A U.L.A. at 649. Finally, "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." *Id.*

[116]Of course, the planner and the client are proceeding from the basic and realistic assumption that the judicial system is prone to unpredictable and sometime incomprehensible results. Accordingly, the same system that prompts a client to seek lawful shelters for his assets may also hold that his proper conduct is tainted and improper.

insolvency.[117] Second, the transferor should use conservative estimates of assets and liberal estimates of debts. This will reduce the transferable surplus, but also negates an intent to defraud because the transferor has erred on the side of protecting creditors. Taken together, these factors will indicate that a transferor lacks fraudulent intent.

It is the intent to harm creditors, and not actual harm, that is central to determining fraudulent intent.[118] The important distinction becomes not whether the transferor *did* retain sufficient assets for his future creditors, but whether the transferor *tried* to retain an adequate cushion. Here, the LRSC substantially aids the transferor in refuting allegations of bad intent. A good faith effort at calculating and retaining reserves is more than mere posturing or window dressing. A transferor who attempts to retain an adequate cushion is deliberately endeavoring to leave enough assets exposed to satisfy legally cognizable claims that might arise in the future. Such an attempt runs counter to any claim that the transferor acted with intent to defraud. This is an effort to afford genuine protection for legitimate future creditors, and is thus antithetical to an intent to defraud.

2. LRSC Issues: Textual Support for the Calculation Principle

UFTA does not expressly set forth the LRSC formula. However, the statute and the accompanying Commissioners' Comments provide ample support for the view that transferors should consider all of their assets and liabilities when planning their transactions, including future balance sheet entries. The LRSC is therefore an algebraic restatement of principles that are expressly or inherently set forth in the text of the Act and the supporting interpretive notes.

It is abundantly clear from the text of UFTA that a transferor must consider both present and future assets.[119] Present assets are obviously included, as shown by the definition of "insolvency," which expressly refers to "*all* of the debtor's assets,"[120] and by the definition of "asset,"

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[117]*See, e.g.*, UFTA § 2(a)-(b), 7A U.L.A. at 648 (describing insolvency in both balance sheet and cash flow terms).

[118]Hence, it has been said that "it is, in fact, actual subjective bad intent that is the necessary requisite to be proven before a transfer can be deemed to have been fraudulent under the Statute of Elizabeth." *In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 391 (Bankr. S.D. Fla. 1991) (applying Florida's enactment of the Statute of Elizabeth, which was in effect until 1988). *Accord* Roland v. United States, 838 F.2d 1400, 1403 (5th Cir. 1988) ("Under the intent test . . ., whether [the debtor] was solvent at the time of the transfer is not dispositive. The crucial element was his *intent* at that time.").

[119]UFTA § 1(2), 7A U.L.A. at 644.

which refers to "property of a debtor."[121] But, apart from excluding certain types of property from the statutory definition,[122] UFTA does not expressly state what should be included as an "asset." Since future assets are not among the items excluded by the definition, proper statutory construction requires "asset" to include future assets as well as present assets.[123]

UFTA's intent to include future assets is further seen in the Commissioners' understanding of the term "asset." In explaining the concept of insolvency, the Commissioners state, "[A]n unliquidated claim for damages resulting from personal injury or a contingent claim of a surety for reimbursement, contribution, or subrogation may be counted as an asset for the purpose of determining whether the holder of the claim is solvent as a debtor."[124] Each of the examples used by the Commissioners are sources of future income, not present income, and each is included in the debtor's assets when determining his solvency, even though such assets have a speculative and unpredictable ultimate value.[125] Likewise, UFTA mandates an assessment of the debtor's future cash flow when testing for constructive fraud.[126] This demonstrates the Commissioners' intent to include future income in any assessment of the debtor's finances, as do other sections of the statute.[127]

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[120]*Id.* § 2(a), 7A U.L.A. at 648 (emphasis added).

[121]*Id.* § 1(2), 7A U.L.A. at 644.

[122]The term "asset" "does not include . . . property to the extent it is generally exempt under nonbankruptcy law." *Id.* § 1(2)(ii), 7A U.L.A. at 644. Further, "assets" do not include encumbered property. *Id.* § 1(2)(i), 7A U.L.A. at 644. The rationale for these exclusions (as well as the exclusion of "interests in valid spendthrift trusts," *id.* § 2, cmt. 1, 7A U.L.A. at 645), is that such interests "are beyond the reach of unsecured creditors," *id.* § 1, cmt. 2, 7A U.L.A. at 645-46, and such interests cannot be used to advance the purpose of the act, which, again, is to preserve assets for the benefit of unsecured creditors. *Id.* § 3, cmt. 2, 7A U.L.A. at 650-51; *accord id.* § 1, cmt. 3, 7A U.L.A. at 646.

[123]This is an application of the "expressio unius" rule, which is fully stated as "'*expression unius est exclusio alterius*' (the expression of one is the exclusion of others)." United States v. Smith, 831 F. Supp. 549, 553 (E.D. Va. 1993) (applying the principal to scope of statutory language in firearm statute); *accord* Boudette v. Barnette, 923 F.2d 754, 756-57 (9th Cir. 1991) (explaining that doctrine creates a presumption that when a statute enumerates or delineates items, "all omissions should be understood as exclusions"). Because UFTA expressly states that certain items do not count as "assets," then all other items should count.

[124]UFTA § 1, cmt. 2, 7A U.L.A. at 645. "Insolvency" is defined in *id.* § 2, 7A U.L.A. at 648.

[125]*Id.* § 1, 7A U.L.A. at 643-45.

[126]Id. § 4(a)(2)(ii), 7A U.L.A. at 653.

[127]For example, § 4(a)(2)(i) considers whether a debtor "was about to engage in a business or a transaction" after a transfer. 7A U.L.A. at 658. Section 4(a)(2)(i) also compares a debtor's post-transfer asset base to his future business or transaction and asks whether that asset base is "unreasonably small" relative to those future risks. *Id.* Such factors necessarily

Taken together, these statutory passages show a legislative intent that a transferor's *future* property should be treated as assets under UFTA. This policy also comports with common sense. After all, future income is often considered a "property" right, similar to employment contracts, income from lease agreements, stock rights, interest on loans or deposits, receivables, and annuities. Such future rights have value and, in some cases, are regularly exchanged and traded in the marketplace. These valuable rights should, therefore, be included in a debtor's asset base to avoid making an incomplete and inaccurate assessment.[128]

UFTA also requires a transferor to assess "debts."[129] Just as future assets are to be included in any UFTA calculations, the duty to consider debts also extends to a debtor's present and future liabilities. The entire thrust of section 4(a) and its "arose . . . after" language is to protect future creditors who are owed future debts.[130] Without this language, debtors could make transfers in total disregard of future creditors, which would wholly undermine the statutory concept of fraud on future creditors.

UFTA's statutory definitions are additional authority for the need to consider future debts. "Debts" are liabilities on "claims,"[131] and "claim" in turn includes "a right to payment, whether . . . unliquidated,

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entail considering the transferor's future business income and future assets. Likewise, § 4(a)(2)(ii) considers whether a debtor "believed or reasonably should have believed that he [or she] *would incur*[] debts beyond his [or her] ability to pay as they became due." *Id.* (emphasis added) (brackets in original). This, too, is prospective language directed to future income and assets. Such language bolsters the view that debtor's may consider future assets when applying the LRSC to their own situation.

[128]Moreover, this statutory construction is fully supported by case law. *See, e.g.*, various cases cited in SPERO, *supra* note 1, ¶ 3.04[1][c][i], including Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 648-49 (3d Cir. 1991) (discussing value of rights of contribution and future earnings potential); Moody v. Security Pac. Bus. Credit, Inc., 127 B.R. 958, 996 (Bankr. W.D. Pa. 1991), *aff'd*, 971 F.2d 1056 (3d Cir. 1992) (discussing reasonable cash flow projections); *In re* Tracey, 88 B.R. 512, 517 (Bankr. D. Mass. 1988) (discussing annual income).

[129]*See, e.g.*, UFTA § 2(a), 7A U.L.A. at 648 (insolvency calculations), *id.* § 2(b), 7A U.L.A. at 648 (cash flow concerns), *id.* § 4(a)(2)(i), 7A U.L.A. at 653 (thin capital concerns), *id.* § 4(a)(2)(ii), 7A U.L.A. at 653 (present and future cash flow concerns).

[130]UFTA § 4(a) states in pertinent part, "A transfer . . . is fraudulent . . . whether the creditor's claim arose before *or after* the transfer was made." *Id.* § 4(a), 7A U.L.A. at 652 (emphasis added). Thus, if the debtor acts with intent to hinder, delay, or defraud, he has committed fraud even though the creditor's claim has not yet been realized. *Id.* § 4(a)(1), 7A U.L.A. at 652.

[131]*Id.* § 1(5), 7A U.L.A. at 644.

. . . contingent, . . . [or] unmatured."[132] These particular rights to payment are all potentially future liabilities.[133]

Likewise, UFTA's provisions regarding constructive fraud also show an intent to include future liabilities.[134] Section 4(a)(2)(i) refers to a debtor's future balance sheet or capital situation,[135] while section 4(a)(2)(ii) considers the debtor's future cash flow situation and his ability to meet payments in the wake of a transfer.[136] While not directly on point, the statutory language demonstrates legislative concern over a transferor's future debts.[137] Hence, as a matter of statutory construction, a transferor is required to consider the rights of others to make calls on his assets in the future. This conclusion also comports with the fact that future creditors have long held rights at common law,[138] which UFTA purports to codify, not repeal.[139]

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[132]*Id.* § 1(3), 7A U.L.A. at 644.

[133]It is also possible that these enumerated items are present liabilities. However, the ordinary meaning of the language used in the definitional section controls the scope of this term. *See, e.g.*, Morales v. Trans World Airlines, Inc., 504 U.S. 374, 383 (1992) (quoting FMC Corp. v. Holliday, 498 U.S. 52, 56-57 (1990); Park 'N Fly, Inc. v. Dollar Park & Fly, Inc., 469 U.S. 189, 194 (1985)) ("[W]e accordingly 'begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.'") (citations omitted); *see also* cases cited *supra* note 62.

[134]UFTA § 4(a)(2), 7A U.L.A. at 653.

[135]UFTA § 4(a)(2)(i) addresses whether a transfer left a debtor too thinly capitalized or in too weak a balance sheet position. *Id.* § 4(a)(2)(i), 7A U.L.A. at 653. The statute considers this factor for both present and future business: The test looks to whether, at the time of transfer, the debtor "was about to engage in a business or a transaction for which the remaining assets . . . were unreasonably small in relation to the business or transaction." *Id.* Put differently, this UFTA section asks whether the debtor's capital and balance sheet situations in the present *and* future will be adversely affected by the transfer.

[136]UFTA § 4(a)(2)(ii) considers whether the debtor "intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due." *Id.* § 4(a)(2)(ii), 7A U.L.A. at 653 (brackets in original). This language is patently concerned with future cash flow performance in the wake of a transfer.

[137]The relevance of § 4(a)(2) to issues under § 4(a)(1) is shown by the fact that both types of UFTA fraud, actual and constructive, share the same ultimate concern of protecting unsecured and undersecured creditors. *See id.* § 1, cmt. 3, 7A U.L.A. at 646; *id.* § 3, cmt. 2, 7A U.L.A. at 650-51; and *supra* note 16. Since the provisions share a common objective and are part of the same statute, the sections dealing with constructive fraud are some indicator of the drafter's concerns over actual fraud.

[138]*See, e.g.*, *In re* Butterworth (1882) 19 Ch. Div. 588, 591 (1882), in which an English court noted the impropriety of commencing a new business venture with thin capital. The debtor had intentionally placed his assets in another person's name immediately before undertaking the new venture. *Id.* at 590. Schreyer v. Platt, 10 S. Ct. 579 (1890), provides a comparable view under U.S. law.

[139]The Commissioners' comments are replete with references to prior case law announced under the old UFCA and the even older Statute of Elizabeth. For example, the Commissioners' discussion of the "badges of fraud" expressly relies upon precedents stretching

Accordingly, future assets and future liabilities should be included in any UFTA analysis.[140] Since the LRSC does just that, it is a valid tool for UFTA analytical purposes, and should be used by planners and their clients when calculating the surplus assets, if any, that may exist for sheltering.[141]

3. LRSC Issues: The Role of Insurance as a Future Asset

A few observations about insurance are in order at this point. Contrary to what many people might think, the transferor who has sheltered assets in an asset protection structure should not suddenly dispense with insurance. Instead, the potential transferor has several good reasons to maintain insurance.

a. *Insurance as a Leveraging Device*

The first reason to maintain liability insurance is that it can be used to "leverage" an estate for pennies on the dollar. Insurance is a contingent future asset and, thus, may be included in the LRSC under certain circumstances. Since insurance policies involve risk spreading, they create a potential asset for a fraction of the value of most policy limits. Consequently, insurance can increase the surplus assets available under the LRSC and thereby allow a client to transfer more of his present assets to an asset protection shelter.[142]

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back to Twyne's Case, 3 Coke 80b, 76 Eng. Rep. 809 (Star Chamber 1601). UFTA § 4, cmts. 5-6, 7A U.L.A. at 654. See also the comments to UFTA § 7, in which the Commissioners cite many older cases in connection with remedies. UFTA § 7, 7A U.L.A. at 660-62.

[140] *Accord* SPERO, *supra* note 1, ¶ 3.04[1][c][i]-[ii]. However, Spero ignores questions of statutory construction in his analysis and instead relies on case law, thereby overlooking the most compelling bases for this conclusion, which are the text of the statute itself and the accompanying comments of the drafters.

[141] There is a modest accounting difference between UFTA and the LRSC. Under UFTA, assets are not included to the extent that they are encumbered by a valid lien, and debts are not counted to the extent that they are secured by a valid lien. *See* UFTA § 1(2)(i), 7A U.L.A. at 644; *id.* § 2, cmt. 1, 7A U.L.A. at 648; *id.* § 2(e), 7A U.L.A. at 648. In other words, collateralized assets and the corresponding debt do not count. This differs from the LRSC, which includes both the debt and the asset securing the debt. However, there is no net change, as both methods mathematically amount to the same thing. For example, if a debtor owns $100,000 in assets and has $40,000 in debt secured by those assets, the LRSC would yield a net surplus of $60,000. UFTA would simply disregard both the debt and the $40,000 of assets securing the debt, which would also yield net assets of $60,000. Hence, the difference is one of methodology and not substance.

[142] For example, in *In re* Kimmel, 131 B.R. 223, 230 (Bankr. S.D. Fla. 1991), the court cited various reasons to uphold certain transfers by a debtor responsible for a causing an auto

As shown above, a transferor is entitled to include contingent assets in his balance sheet,[143] and insurance is potentially the transferor's most important contingent asset. This asset will materialize if and when certain covered liabilities also materialize. For example, a professional such as a doctor, lawyer, or accountant will often obtain insurance dollars if a malpractice claim is filed against him; a driver with car insurance will frequently obtain insurance dollars if he causes an auto accident; and business owners can claim against their premises liability policy if somebody is injured on their property. In these circumstances, when the contingent liability of a future claim materializes, proper liability insurance will in many instances partially or wholly negate the impact of that liability on the LRSC.[144] The effect of contingent insurance payouts is to maximize the amount of surplus assets. The following example illustrates this principle.

Assume that the transferor is an uninsured doctor in a high risk field, such as neurology, and that he has a total of ten years left to his practicing career. Assume also that the transferor has present assets of $2 million and present liabilities of $1.6 million for items such as home and office mortgages, equipment debts, and other matters. Looking strictly at present assets and liabilities, the transferor has a net transferable surplus of $400,000. Due to the high risk nature of his business, the transferor also knows that there is a good statistical probability that he will eventually be sued and forced to pay a plaintiff, pursuant to either a judgment or a settlement. Assuming that there is a 100% possibility of eventually incurring a $750,000 judgment, and also assuming for simplicity of illustration that all other future assets and

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accident, including the fact that the debtor had insurance.

[143]*See supra* note 142; *see also* UFTA § 1, cmt. 2, 7A U.L.A. at 645-46 (stating that various contingent and unliquidated claims count as "assets" when calculating insolvency under UFTA § 2).

[144]It is important to note that all of the above examples are based on what accountants call the "matching principle." Under this principle, assets and liabilities are "matched," or paired together, based upon the fact that both were generated by the same or a substantially related activity. *See, e.g.*, GLENN A. WELSCH ET AL., FUNDAMENTALS OF FINANCIAL ACCOUNTING 64-66 (4th ed. 1984) (summarizing *Fundamental Concepts Underlying Financial Accounting and Reporting* (based on FASB Statements of Concepts Nos. 1, 2, and 3)). For LRSC purposes, this principle means that payouts by a homeowner's insurance policy can be considered when calculating scenarios recognizing possible homeowner liabilities, but homeowner's insurance cannot be included when calculating scenarios involving possible professional malpractice liabilities. The reason for excluding homeowner's insurance from a medical malpractice scenario is both obvious and logical. A homeowner's policy will not cover medical malpractice claims and, thus, has no bearing on LRSC tallies that consider malpractice risks.

liabilities will equal each other at $1 million and hence be a "wash," the following LRSC results for the uninsured doctor:

	Present Assets	$2,000,000
+	Reasonably Foreseeable Future Assets	1,000,000
		$3,000,000
-	Present Debts	1,600,000
-	Reasonably Foreseeable Future Debts: Other Than Projected Malpractice Liability	1,000,000
-	Reasonably Foreseeable Future Debts: Projected Malpractice Liability	750,000
=	Net Deficit	$ (350,000)

Under this calculation, the doctor has no transferable surplus and, therefore, cannot transfer assets without violating UFTA. If the doctor makes asset transfers despite knowledge of the above equation, then a future malpractice claimant may have a strong argument that the doctor acted with intent to hinder, delay, or defraud future creditors, i.e., that the doctor committed actual fraud. At the very least, the malpractice claimant is likely to have a strong argument that the doctor unwittingly rendered himself insolvent and thus committed constructive fraud as to future creditors. Consequently, the doctor is faced with an ugly choice — either risk financial ruin, or break the law.

Liability insurance can dramatically change this outcome. Assume that the doctor spends $25,000 to buy a ten year malpractice policy with a $1 million limit, and that the policy will actually pay $750,000 to cover the plaintiff's claim. This causes the following significant change in the equation:

	Present Assets	$2,000,000
+	Insurance Payout	750,000
+	Reasonably Foreseeable Future Assets Apart From Insurance Payout	1,000,000
		$3,750,000
-	Present Debts	1,600,000
-	Malpractice Premium	25,000
-	Reasonably Foreseeable Future Debts: Other Than Projected Malpractice Liability	1,000,000
-	Reasonably Foreseeable Future Debts: Projected Malpractice Liability	750,000
=	Net Surplus	$ 375,000

Admittedly, the numbers used in this revised scenario are not realistic. A doctor is unlikely to operate on a break even basis during the last decade of his career, and malpractice insurance is likely to cost much more than $25,000 over ten years. Nonetheless, this revised scenario illustrates a very important point: insurance is an inexpensive way to add to the bottom line. By spending $25,000 for malpractice insurance, the doctor moves from a net deficit of $350,000 to a net surplus of $375,000, which is a "swing" of $725,000 in the doctor's favor. Not only has he avoided insolvency caused by a predictable claim against someone in his field, but he has now created a net surplus of $375,000, which he can shelter in any one of a variety of protective structures.

Further, recall that theories of liability that are not yet legally recognized do not count as "claims" or "debts" under UFTA[145] and, thus, may be ignored in the LRSC. Only presently cognizable "claims" need be considered. Consequently, the doctor has a valuable window of opportunity. If the doctor fears that the ever expanding scope of liability might someday make him liable on a theory that is presently regarded as bizarre and nonactionable, he can act today to shelter those assets. These concerns may not even be related to his medical practice. The doctor may be more concerned about guests being injured in his backyard swimming pool than in a medical malpractice claim. Nonetheless, the above illustration shows that the doctor will have a significant net deficit and will not be able to protect himself against any future suits unless he first mitigates the impact of the predicted malpractice claim. However, by purchasing malpractice insurance, the doctor can go from a net deficit to a net surplus and can shelter his surplus while still complying with UFTA.

Therefore, transferors have ample incentive to maintain adequate liability insurance, both before and after they shelter assets. Insurance can substantially increase the asset component of the LRSC and will commensurately increase the tally of surplus assets that may be sheltered. This means that the debtor has leveraged his assets and increased his net estate, which allows the debtor to transfer more of his noninsurance assets (e.g., cash, securities, collectibles, etc.) into a protective structure.

b. *Insurance Negates Fraudulent Intent*

The presence of insurance in a client's portfolio also negates fraudulent intent in much the same way that retention of any asset does.

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[145]*See* UFTA § 1(3)-(4), 7A U.L.A. at 650-53.

By making funds available for potential claimants, the transferor is attempting to protect, not defraud, his potential creditors.

Some transferors may object to this approach on the theory that they want to shelter assets in order to dispense with the need for insurance. Once these transferors are ostensibly sheltered, they will want to know why they should maintain their expensive insurance.

Several appropriate responses are in order. First, as noted above, insurance may be included LRSC.[146] Including insurance enables a transferor to use the premiums to "leverage" his assets and increase the size of the surplus. Hence, a transferor has a positive incentive to maintain insurance.

Second, an asset protection plan only protects the transferor's accumulated capital but does not protect his future income from creditors because that income is not yet sheltered.[147] This point is often overlooked. A creditor can use various devices to reach future income and deprive the transferor of the fruits of his future labor. For instance,

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[146]*See supra* note 144.

[147]This observation does not strictly apply to all income. For instance, many asset protection plans involve the use of offshore APTs in which the transferor is both settlor and beneficiary, which is permissible under the laws of some jurisdictions. *See, e.g.*, SPERO, *supra* note 1, app. D (Cook Islands International Trust Act § 13C (1984 as amended)). The same provisions of the trust legislation that protect the trust corpus will also protect the trust income so long as the income is retained by the trustee. Likewise, the income and gains paid to an ERISA plan trustee are generally off-limits to creditors of the plan's beneficiary so long as such accretions are held in trust. *See infra* note 160. Even these income protections suffer from limits. The APT may protect the income from creditors, but the threat of creditors may prompt the trustee to withhold distribution, thus effectively cutting off the APT beneficiary, who is also the transferor, from his trust income. Similarly, the assets of an ERISA plan lose their exempt character upon distribution to the plan beneficiary. *See In re* Cesare, 170 B.R. 37, 39 (Bankr. D. Conn. 1994) (stating general rule regarding distributions of exempt property).

As an important aside, note that Delaware and Alaska recently enacted statutes creating the first true asset protection trust (APT) under U.S. law. In 1997, both states legislatively decreed that a person who fulfills certain conditions may settle a discretionary trust with her own property, name herself as a beneficiary, and, most significantly, insert a spendthrift clause that will be valid against her own creditors. *See* Del. Qualified Dispositions in Trust Act, DEL. CODE ANN. tit. 12, § 3570 (1997) (in general); *id.* § 3570(9)(c) (regarding restraints on alienation of beneficiary's interest); *see also* Alaska H.B. 101, 20th leg., 1st Sess. (Alaska 1997) (amending various provisions of Alaska statutes). Hence, U.S. residents may now use domestic trusts to put their own assets beyond the reach of their own creditors, all the while still enjoying the use and benefit of those assets. This is nothing less than a revolution in American trust law. Moreover, this sea-change harmonizes with the basic concept underlying various offshore APT statutes. *See, e.g.*, SPERO, *supra* note 1, app. D. (Cook Islands International Trust Act §§ 13C (1984 as amended) (allowing settlor to be beneficiary), § 13F (allowing spendthrift clauses). However, despite the considerable change wrought by Delaware and Alaska, there are still some key differences between these new U.S. statutes and their offshore counterparts.

state collection laws allow creditors to employ various devices, such as creditor's bills,[148] garnishments of wages and accounts,[149] attachments of property (including receivables),[150] and receiverships over a debtor's business and affairs.[151] Moreover, all local remedies are available in federal court if the creditor holds a federal judgment.[152] This means that a client's future income is highly vulnerable regardless of what he has done to shelter previously acquired assets. Consequently, a transferor should retain insurance to pay off claims that might otherwise stand between him and his future cash flow.

Third, and somewhat more dramatic, a successful fraudulent transfer UFTA suit will render a protection plan amenable to unraveling, thus defeating the purpose of the plan.[153] Other negative consequences could also accrue. For instance, a transferor and his transferee may be exposed to a money judgment for actual and punitive damages.[154]

A variety of criminal problems could also arise from fraudulent transfers. At least one federal appellate decision indicates that fraudulent

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[148]OHIO REV. CODE ANN. § 2333.01 (Anderson 1995). This statute, and others like it in other states, entitles a creditor to sue persons who owe money to the judgment debtor and to redirect third party payments to the judgment creditor. *Id.* Such suits are commonly known as a "creditor's bill." Moreover, even in states that do not specifically provide for a creditor's bill, it is possible to achieve a similar result by obtaining an injunction pursuant to the rules governing injunctive relief in general.

[149]MD. CODE ANN. § 2-646 (1996).

[150]735 ILL. COMP. STAT. § 5/12-158 (West 1993).

[151]OHIO REV. CODE ANN. § 1901.13 (Anderson 1994); OHIO REV. CODE ANN. § 2333.22 (Anderson 1995); Mentor Landscapes & Supply Co. v. Campbell, 620 N.E.2d 149 (Ohio Ct. App. 1993) (appointing a receiver of business assets).

[152]FED. R. CIV. P. 69(a).

[153]However, as discussed in *infra* note 164 and accompanying text, assets held in a foreign trust that is governed by laws that do not recognize U.S. judgments may not be effected by a successful fraudulent transfer suit.

[154]UFTA § 8(b), 7A U.L.A. at 662, allows for money damages against a transferee under certain circumstances, and UFTA § 10, 7A U.L.A. at 666, states that UFTA's remedies are supplemental to other legal and equitable relief. Further, state law often allows for punitive damages for intentional misconduct. *See, e.g.*, OHIO REV. CODE ANN. § 2315.21(A)-(B) (Anderson 1995) (allowing punitives in "tort" claims involving "malice, aggravated or egregious fraud, oppression, or insult" and broadly defining "tort"); Lawrence v. Virginia Ins. Reciprocal, 979 F.2d 1053, 1057 (5th Cir. 1992) (allowing punitive damage award for gross intentional misconduct); Prudential Property & Cas. Ins. Co. v. Mohrman, 828 F. Supp. 432, 440-41 (S.D. Miss. 1993) (allowing punitives for "wilful or malicious wrong," "gross or reckless disregard for the rights of others," "'gross, callous, or wanton conduct,'" and acts "accompanied by fraud and deceit") (citations omitted) (quoting Life & Cas. Ins. Co. v. Bristow, 529 So.2d 620, 622 (Miss. 1988)). Such punitive relief would presumably extend to transferors and transferees who intentionally defraud creditors, however, this may vary from state to state.

transfers executed by mail and wire can be mail or wire fraud.[155] In addition, some states have decreed fraudulent transfers to be crimes.[156] Finally, there is always the possibility that the poorly written and convoluted Money Laundering Control Act[157] could be invoked as a basis for criminal prosecution.

Therefore, to negate fraudulent intent and otherwise protect against severe consequences, the transferor should maintain healthy insurance policies. Policy payouts will avoid controversies in many cases. Further, even if the insurance coverage is inadequate for some reason, the retention of insurance should still be a powerful indicator of a transferor's good faith and lack of bad intent.[158] Due to that good faith, the client's plan is far more likely to withstand attack, even if policy limits are exceeded, thereby increasing the likelihood that the sheltered assets will remain beyond the reach of judgment creditors. For all these reasons, a transferor should retain adequate insurance, even if he has sheltered many of his assets.

4. LRSC Issues: Assets to be Excluded

Certain assets must be excluded from asset tallies under the LRSC. Such assets generally include any assets that are already sheltered from creditor claims, even if the assets are still under the debtor's control. The theory behind this exclusionary approach is simple. If an asset is beyond the reach of creditors, then it is not really an asset available to satisfy creditor claims and, therefore, should not be counted. Specific examples of such assets include property that is exempt from attachment, either under state or federal law. This could, for instance, include a debtor's exempt interest in a homestead, which is a state law exemption,[159] and

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[155]United States v. Feldman, 853 F.2d 648, 654 (9th Cir. 1988).

[156]*See, e.g.*, CAL. PENAL CODE §§ 531, 531(a) (West 1988) (making fraudulent transfers a misdemeanor); OHIO REV. CODE ANN. § 2913.45(A)(1) (Anderson 1996) (stating that a debtor may not "[r]emove, conceal, destroy, encumber, convey, or otherwise deal with any of the person's property" "with purpose to defraud one or more of the person's creditors"); *id.* § 2913.01(B) (broadly defining "defraud" for criminal purposes).

[157]18 U.S.C. § 1956 (1995).

[158]This, of course, assumes that the transferor does not appear to have intentionally purchased inadequate amounts of coverage.

[159]*See, e.g.*, the Florida homestead exemption, FLA. CONST. art. 10, § 4; FLA. STAT. ANN. §§ 222.01-.02 (1989) (making homestead wholly exempted from most creditors); TEX. CONST. art. 16, §§ 50-51 (protecting homestead from creditors); TEX. PROP. CODE ANN. §§ 41.001-.002 (West 1984) (same); MASS. GEN. LAWS ANN. ch. 188, §§ 1-1A (1991 & Supp. 1997) (providing homestead exemptions of $100,000 and $200,000 for elderly and disabled persons). Other states, however, often provide much more limited protection, and in some

could also include a debtor's interest in an ERISA trust account, which is subject to spendthrift protection under federal law.[160] Likewise, property held via a tenancy by the entireties should be excluded if the debtor resides in a jurisdiction that still recognizes such an estate. It is generally held that debts of one tenant cannot be satisfied out of property jointly held by the entireties.[161] Similarly, a debtor's beneficial interest in a spendthrift trust should be excluded to the extent that interest is unattachable under state law.[162]

This exclusionary rule also requires exclusion of property that has been properly settled into an offshore asset protection trust (APT).[163] One

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instances may even provide no homestead exemption. *See* STEFAN A. RIESENFELD, CASES AND MATERIALS ON CREDITORS' REMEDIES AND DEBTOR'S PROTECTION 217, 292 (4th ed. 1987) (listing Connecticut, Delaware, Maryland, New Jersey, Pennsylvania, and Rhode Island as states which do not possess homestead exemptions).

[160]ERISA (Employee Retirement Income Security Act) is a federal statute governing certain pension plans. Under federal law, an ERISA pension plan must have a spendthrift provision, as required by 29 U.S.C. § 1056(d)(1) (1985), which states that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated." Consequently, the money built up in a properly drafted ERISA plan is, as a general rule, beyond the reach of creditors. There are certain exceptions, the most significant of which is for QDRO's (Qualified Domestic Relations Orders). *Id.* § 1056(d)(3)(A). This exception basically means that various forms of spousal or child support orders (or agreements) may be enforced by attaching the debtor's ERISA interest. Likewise, fiduciaries who cause plan losses may have their interest in a plan subject to attachment. *Id.* § 1109(a).

However, as a general rule, the interest of a plan participant is exempt pursuant to federal law. This has been affirmed on at least two separate occasions by the Supreme Court. For instance, in Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365 (1990), the Court held that a corrupt union official's interest in an ERISA fund could not be subjected to a constructive trust for the benefit of creditors, even though the creditor was the union, and even though the debtor had embezzled from the union (not the ERISA fund itself). *Id.* at 372-74. Likewise, in Patterson v. Shumate, 504 U.S. 753 (1992), the Court held that a Chapter 7 debtor's ERISA interest was not includable in his bankruptcy estate, thereby keeping the ERISA money away from the debtor's creditors in bankruptcy. *Id.* at 765. Indeed, in *Guidry*, the Court even referred to § 1056(d) as an "antigarnishment provision." *Guidry*, 493 U.S. at 376.

[161]*See, e.g.*, Hurlbert v. Shackleton, 560 So. 2d 1276, 1278 (Fla. Dist. Ct. App. 1990) (finding that husband's portion of assets which were held with his wife as tenants by the entireties could not be applied to satisfy his judgment debt); Page v. Corn Exch. Nat'l Bank & Trust Co., 171 A. 560, 562 (Pa. 1934) (holding that a conveyance of property which is in both a husband and wife's name cannot be deemed as fraudulent against husband's creditors).

[162]See, e.g., UFTA § 2, cmt. 1, regarding insolvency, which states that "interests in valid spendthrift trusts . . . that cannot be severed by a creditor . . . are not included" in a debtor's asset base. UFTA § 2, cmt. 1, 7A U.L.A. at 648.

[163]Lawrence Ponoroff, *Exemption Limitations: A Tale of Two Solutions*, 71 AM. BANKR. L.J. 221, 226 n.24 (1997) (defining asset protection trust as "essentially self-settled spendthrift trusts established in jurisdictions that do not recognize fraudulent transfer judgments from foreign countries and whose own fraudulent disposition laws deliberately do not cover this

of the key attributes of an APT is that property held in trust is beyond the reach of creditors for many reasons, including the host jurisdiction's nonrecognition of U.S. judgments,[164] short statutes of limitations,[165]

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situation"). The Cook Islands, Gibraltar, Belize, and the Cayman Islands are among the popular locations for these trusts. *Id.*

[164]*See, e.g.*, Nevis International Exempt Trust Ordinance (1994 as amended) §§ 28, 29 (prohibiting enforcement of any judgment that was obtained in a foreign jurisdiction); SPERO, *supra* note 1, at app. D (Cook Islands International Trust Act §§ 13D, 13H, 13I (providing exclusivity to the laws of the Cook Islands with regard to all questions arising under an international trust)). Pursuant to these provisions, U.S. judgments regarding trusts settled under Nevis or Cook law are generally not recognized by the courts of those jurisdictions. Additionally, in other jurisdictions, such as Jersey, Guernsey, the Isle of Man, and elsewhere, it is commonly thought by many practitioners that their jurisdictions will not recognize U.S. judgments. *See* Judgments (Reciprocal Enforcement) (Isle of Man) Act 1968 § 1 (authorizing governor to extend recognition of judgments to reciprocating countries). Nearly identical statutory language can be found in the following national laws: The Reciprocal Enforcement of Judgments (United Kingdom) Order 1973 (adopting the policy of the Isle of Man for extending recognition to the judgments of reciprocating countries); The Reciprocal Enforcement of Judgments (Italy) Order 1977; The Reciprocal Enforcement of Judgments (Netherlands) Order 1977; The Reciprocal Enforcement of Judgments (Israel) Order 1977; The Reciprocal Enforcement of Judgments (The Netherlands) (Amendment) Order 1982; The Reciprocal Enforcement of Judgments (Suriname) Order 1982; The Reciprocal Enforcement of Judgments (Jersey) Order 1991; The Reciprocal Enforcement of Judgments (Guernsey) Order 1991.

For instance, the Manx reciprocal judgment legislation and related regulations do not include the U.S. among the list of countries whose judgments are automatically recognized. Instead, automatic recognition is limited to judgments from the United Kingdom, Italy, The Netherlands, Israel, Suriname, Jersey and Guernsey. *See* Judgments (Reciprocal Enforcement) (Isle of Man) Act 1968 § 1.

Arguably, a U.S. judgment could be transferred to a recognized jurisdiction, such as England, and upon the U.S. judgment becoming an English judgment, the judgment might then be transferred to Manx courts. *See, e.g.*, Video Vision Broadcast v. Stapleford Flying Club Ltd., 1990-92 Manx L. Rep. 236 (1991). However, in *Video Vision*, the judgment in question originated in a lower English court, which was not among the particular English courts enumerated in the Manx legislation, but which was nonetheless an English court. *Id.* at 237. Hence, Manx recognition of a lower English court judgment by this "backdoor" method does not violate the clear policy of the Manx legislation and regulations, which is to confer reciprocity on English courts and their judgments. *Id.* at 239. In contrast, use of this "backdoor" approach to transfer a U.S. judgment would certainly be contrary to the Manx policy of nonreciprocity for U.S. judgments. It is also possible to have a trust in the Isle of Man that is governed by non-Manx law, including the laws of jurisdictions that expressly do not recognize U.S. judgments, such as Nevis or the Cook Islands. *See* Manx Recognition of Trusts Act (1988), Schedule 1, art. 6, 8 (allowing choice of foreign law in trusts); Manx Limitation (Amendment) Act 1988, Schedule 1A (applying foreign limitations periods to foreign governed trusts, *i.e.* non-Manx, law). Under this latter scenario, even if Manx courts could generally recognize U.S. judgments via the "backdoor," the choice of Nevis or Cook law in connection with a particular trust could bar recognition in that specific instance.

It is also generally believed in the Isle of Man that a U.S. judgment creditor could start a common law action to force recognition of a U.S. judgment. However, this would entail a whole new lawsuit, which would be far more cumbersome than a simple and automatic

abolition of claims by future creditors,[166] and elevated legal standards for claims by present creditors.[167] As this property is essentially exempted

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recognition of judgments pursuant to a reciprocity statute. In any event, such suits may not succeed. Further, the problems generally associated with an action on a judgment are made worse in cases of trusts governed by the laws of a jurisdiction that does not recognize U.S. judgments, such as the Cooks or Nevis.

Lastly, Spero concurs that assets held in an APT should be excluded from asset tallies. SPERO, *supra* note 1, ¶ 3.04[1][c][i], at 3-25.

[165]*See, e.g.*, Nevis International Exempt Trust Ordinance § 24(3) (providing for limitation periods of one and two years); SPERO, *supra* note 1, at app. D (Cook Islands International Trust Act §§ 13B(3)) (same). Under these provisions, the typical creditor has only a two year period to bring claims, and under certain circumstances may have only one year.

[166]*See, e.g.*, Nevis International Exempt Trust Ordinance § 24(4) (1994 as amended) ("A trust settled or established and a disposition of property to such trust shall not be fraudulent as against a creditor of a settlor if the settlement establishment or disposition of property took place before that creditor's cause of action against the settlor accrued or had risen."); SPERO, *supra* note 1, at app. D (Cook Islands International Trust Act § 13B(4) (1984 as amended)) (using identical statutory construction). Pursuant to these provisions, future creditors have no standing to assert fraudulent transfers claims regarding transfers to trust. Only present creditors have standing to assert such claims. The Bahamian Fraudulent Disposition Act § 2 (1991), is arguably even more burdensome on creditors. This provision of the Bahamas statute defines "creditor" as somebody owed an "obligation," and in turn defines "obligation" as "an obligation or liability (which shall include a contingent liability) which existed *on or prior* to the date of a relevant disposition *and* of which the transferor had *actual notice*." The Bahamian Fraudulent Disposition Act § 2 (1991) (emphasis added). Under this phrasing, even present creditors are without rights if the transferor did not know of the creditor's claim at the time of transfer. However, if the transferor did not have notice, then the transfer is substantially less likely to have been made with intent to defraud. Thus, the transferor is free from the ill intent that is required for actual fraud, at least as to that particular creditor.

[167]Under the Cook and Nevis statutes, a present creditor must prove both bad intent and harmful effect. Nevis International Exempt Trust Ordinance § 24(1) (1994 as amended); SPERO, *supra* note 1, at app. D (Cook Islands International Trust Act § 13B(1) (1984 as amended)). Specifically, a plaintiff must show that the transfer rendered the transferor insolvent (or otherwise without property to pay a valid present creditor claim) and that the transferor acted with intent to defraud. *Id.* This contrasts with American law, which allows proof of either intent (actual fraud) or effect (constructive fraud) to suffice. UFTA § 4(a)(1)-(2), 7A U.L.A. at 652-53. Additionally, Nevis and the Cooks require the plaintiff to prove both bad intent and harmful effect "beyond a reasonable doubt." SPERO, *supra* note 1, at app. D. (Cook Islands International Trusts Act § 13B(1) (1984 as amended)); Nevis International Exempt Trust Ordinance § 24(1) (1994 as amended). This contrasts with American burdens of proof, which sometimes are only a mere preponderance, and at other times are elevated to the "clear and convincing" standard, but which are never elevated to "beyond a reasonable doubt" in civil fraudulent transfers suits. *See infra* note 214. Finally, Nevis and the Cooks both require proof that the transferor acted with intent to defraud the particular plaintiff. Nevis International Exempt Trust Ordinance § 24(1) (1994 as amended) (requiring a showing that the intent was "to defraud that creditor of the settler"); SPERO, *supra* note 1, at app. D (Cook Islands International Trusts Act § 13B(1)(a) (1994 as amended)) (requiring a showing of fraud identical to the Nevis' statute). A mere generalized intent to defraud will not suffice, which

from attachment by operation of foreign law, such trust assets should be excluded from a client's LRSC in the same fashion that domestic exempt property is excluded, unless the client consents to a pledge arrangement or otherwise makes the trust property available. Finally, assets that have been — or, at least, arguably have been — fraudulently transferred by the transferor should also be excluded, since they are also hard to reach and will not be readily available to satisfy a judgment.

These conclusions are consistent with UFTA and its approach, as shown by UFTA sections 1 and 2 and the related Commissioners' Comments. For instance, pursuant to section 1, UFTA's definitional section, exempt property and tenancies by the entireties are excluded from the definition of "asset" and are hence removed from a client's asset base for UFTA purposes.[168] Similarly, under section 2, which defines "insolvency," fraudulently transferred property is excluded from "assets" when making solvency determinations,[169] as is property held in a proper spendthrift trust.[170] Finally, the Commissioners have stated:

> [The Uniform Fraudulent Transfer Act], like its predecessor and the Statute of 13 Elizabeth, declares rights and provides remedies for unsecured creditors against transfers that impede them in the collection of their claims. The laws protecting valid liens against impairment by levying creditors, exemption statutes, and the rules restricting levyability of interest in entireties property are limitations on the rights and remedies of unsecured creditors, and it is therefore appropriate to exclude property interests that are

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again contrasts with the law of at least some American jurisdictions in which an intent to defraud one creditor is treated as imputed intent to defraud all creditors (including present and future creditors). *See supra* note 25.

[168]UFTA § 1(2)(i)-(ii), 7A U.L.A. at 644 ("'Asset' . . . does not include property to the extent it is generally exempt under nonbankruptcy law; or an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant."). The statutory definition of "asset" also excludes "property to the extent it is encumbered by a valid lien." *Id.* § 1(2)(i), 7A U.L.A. at 644. As noted, this differs slightly from the LRSC, which includes both the asset and the accompanying lien, yet the net effect should be the same under either approach. *See supra* note 141.

[169]UFTA § 2(d), 7A U.L.A. at 648 ("Assets under this section do not include property that has been transferred, concealed, or removed with intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer voidable under this [Act].") (alteration in original).

[170]*See supra* note 122.

> beyond the reach of unsecured creditors from the definition of "asset" for the purposes of this Act.[171]

Accordingly, property that is beyond the reach of creditors should not be considered when undertaking LRSC analyses. This, of course, creates a limit on the client's right to shelter still more assets. Exclusions of property from asset tallies will *pro tanto* reduce the LRSC's calculated net surplus. However, the reduced surplus is attributable to the fact that the client has already found a safe harbor for some of his assets and is already protected to some degree. The only question is how much more the client can lawfully shelter.

5. LRSC Issues: UFTA's Rule of Reason Approach to Determining Future Assets and Liabilities

a. *The Rule of Reason*

When applying the LRSC to any particular case, planners will often be confronted with a seemingly difficult task. Specifically, how do planners and clients gaze into a crystal ball and predict future assets and liabilities? The answer, of course, is that they cannot be realistically expected to provide accurate or precise projections of long-term finances, since there is an endless possibility of mitigating variables. Fortunately, UFTA does not require certainty but, instead, imposes a lower and more workable standard of reasonableness and fairness which can accurately be described as the "rule of reason" approach.

For instance, UFTA requires that assets and debts be appraised at a "fair valuation," as seen in the clause defining solvency,[172] and again in the Commissioners' Comments regarding solvency, which emphatically restate the "fair valuation" requirement.[173] The "fair valuation" language, which is simply another way of stating a reasonableness standard, harmonizes with other parts of UFTA, which expressly speak in terms of reasonable valuations or appraisals. Thus, UFTA refers to "reasonably equivalent value" in numerous places.[174] Likewise, in connection with

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[171]UFTA § 1, cmt. 2, 7A U.L.A. at 645-46.

[172]In defining insolvency, UFTA § 2(a) 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.

[173]*Id.* § 2, cmt. 1, 7A U.L.A. at 648 ("The definition . . . contemplate[s] a fair valuation of the debts as well as the assets of the debtor.").

[174]*See, e.g.*, UFTA §§ 4(a)(2), 4(b)(8), 7A U.L.A. at 652-53. UFTA does not define what is reasonably equivalent value (REV). *Id.* § 3, cmt. 3, 7A U.L.A. at 651. Accordingly,

constructive fraud, UFTA section 4(a)(2)(ii) tests whether the debtor "believed or *reasonably* should have believed that he [or she] would incur debts beyond his [or her] ability to pay as they became due."[175] Similarly, UFTA section 4(a)(2)(i) considers whether a transfer left a debtor with an "unreasonably small" asset base relative to his business or other ventures.[176]

Furthermore, case law agrees that only reasonably foreseeable claims should be considered. For instance, a Pennsylvania case stated that the term "future creditor" is someone with claims that are "reasonably foreseen as arising in the immediate future."[177] Simply stated, "a 'future creditor' does not exist unless a conveying party can reasonably foresee incurring the costs of a claim or judgment at the time of the conveyance."[178]

Hence, UFTA requires a transferor to calculate both his present and future assets and liabilities on a reasonable basis that reaches "fair valuations."[179] This means that the LRSC must also be calculated by using reasonable (or "fair") future valuations. Admittedly, "reasonable" is a somewhat nebulous test, but this is hardly unique to UFTA.

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whether value is reasonably equivalent must be determined on a case-by-case basis. *See, e.g.*, *In re* Dondi Fin. Corp., 119 B.R. 106, 109 (Bankr. N.D. Tex. 1990) (explaining that "cases are fact specific" as to companion doctrine of "fair consideration" under UFCA); *see also* Zahra Spiritual Trust v. United States, 910 F.2d 240, 249 (5th Cir. 1990) (holding that the particular facts showed that the debtor did not receive REV on his contributions to a nonprofit corporation). Therefore, the focus is on the "economic reality" of a situation. *See In re* Miami Gen. Hosp., Inc., 124 B.R. 383, 394 (Bankr. S.D. Fla. 1991). However, some insight into the meaning of "reasonably equivalent value" is provided by UFTA § 3(b), which states that

> a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

UFTA § 3(b), 7A U.L.A. at 650. These nonexhaustive examples of REV are also cited by Congress in 28 U.S.C. § 3303(b), which is the statute dealing with transfers intended to defraud the federal government in its capacity as a creditor. 28 U.S.C. § 3303(b) (1994). As these examples involve forced sales, which usually result in deep discounts, it is apparent that REV does not have to match 100% of the fair market value of a voluntary sale. *Accord* Parts Depot, Inc. v. Bullock, 545 So. 2d 468, 470-71 (Fla. Dist. Ct. App. 1989) (finding no evidence of fraud even where a father paid only a small portion of the value of the transferred property in question).

[175]UFTA § 4(a)(2), 7A U.L.A. at 653 (emphasis added) (brackets in original).

[176]*Id.* § 4(a)(2)(i), 7A U.L.A. at 653.

[177]Leopold v. Tuttle, 549 A.2d 151, 154 (Pa. Super. Ct. 1988).

[178]*Id.* (citation omitted) (construing UFCA).

[179]*See, e.g.*, UFTA §§ 4(a)(2), 4(b)(8), 7A U.L.A. at 652-53.