

# FRAUDULENT TRANSFERS: WHAT YOU NEED TO KNOW



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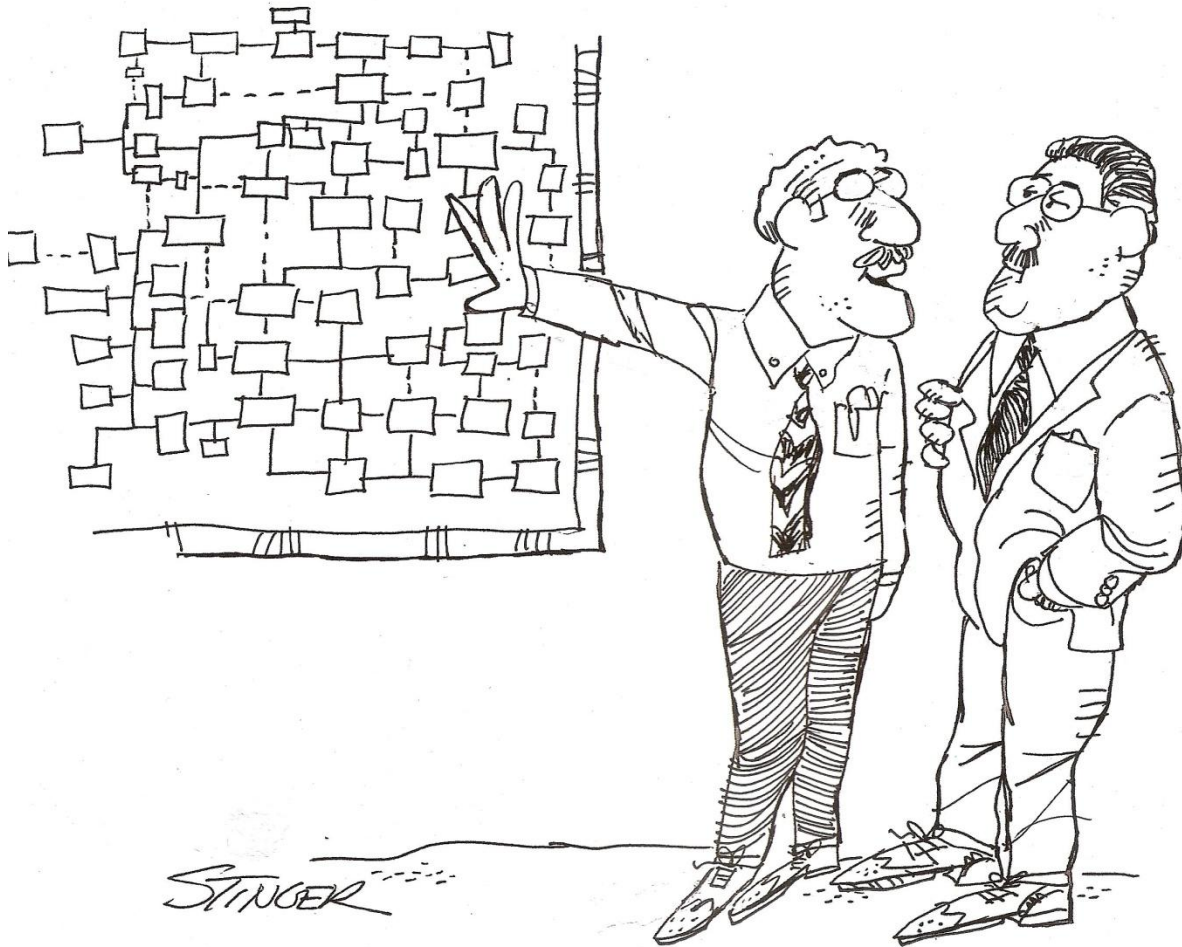
# Do You Really Know Your Customer?



# What Type of Legal Entity?



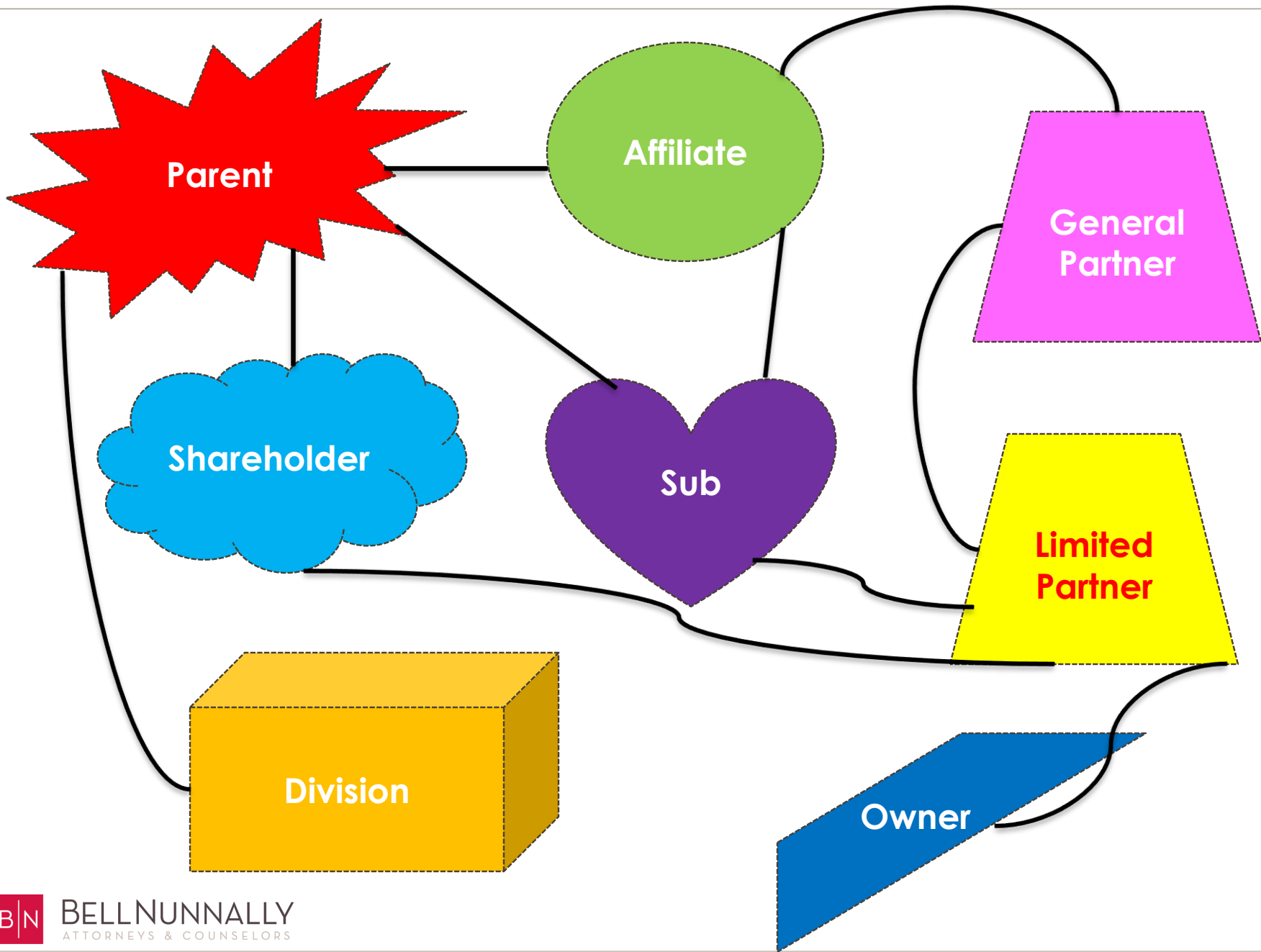
- Sole proprietorship
- Partnership
  - General
  - Limited
- Corporation
- LLC



**What is the  
Relationship?**

**Where are the  
Assets??**

“We’ve reorganized so many times we are now one of our own subsidiaries.”



# FRAUDULENT TRANSFERS



# FRAUDULENT TRANSFERS



Transfer of assets to wrongfully avoid unsecured debt claims and defraud creditors

- Around the time debt incurred
- After a debt incurred
- After demand made on debt
- After lawsuit filed on a debt
- Around the same time or after a judgment entered on a debt
- Before or even after bankruptcy

# FRAUDULENT TRANSFERS



Secured debt claims vs. unsecured debt claims

- Lien holders have built in remedies that follow the property itself.
- May also assert fraudulent transfer claims but have more direct and other claims – foreclosure, conversion, etc.



# FRAUDULENT TRANSFERS



What assets are included?

- ✓ All assets!
- ✓ Money/Funds
- ✓ Personal property
- ✓ Real property
- ✓ “Soft” assets
  - Membership interests, shares
  - Accounts, debts, contracts

# FRAUDULENT TRANSFERS



- State law
  - Uniform Fraudulent Transfer Act (now known as the Uniform Voidable Transactions Act)
  - Adopted/enacted by most states
  - Codified differently in each state
    - Texas, for example, found in Chapter 24 of the Texas Business and Commerce Code.

 **Federal Bankruptcy Code 11 USC §548**  
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# UNIFORM CLAIMS

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

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

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

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

(B) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

Tex. Bus. Com. Code 25.005

# 11 USC § 548



The trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation .... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the [bankruptcy] petition, if the debtor voluntarily or involuntarily—

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

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

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

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

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

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

# BADGES OF FRAUD

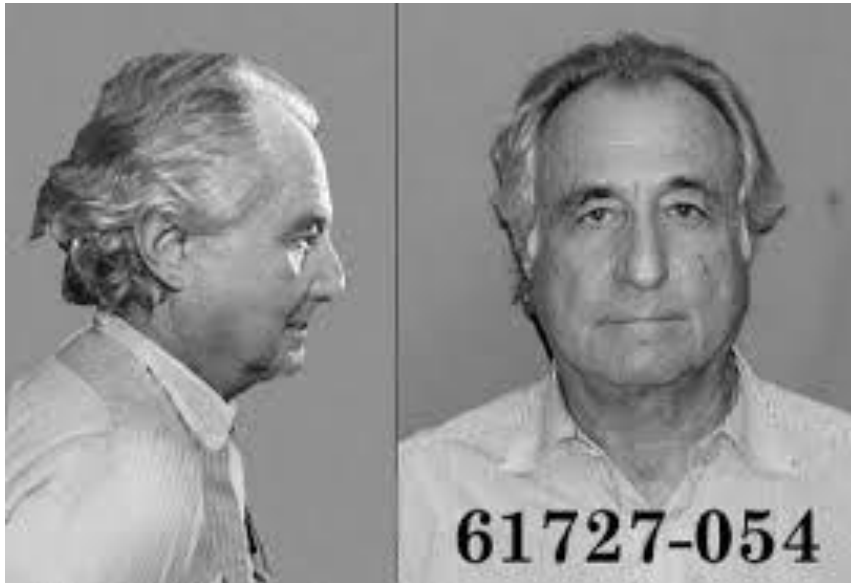
In determining actual intent .... consideration may be given, among other factors, to whether:

- ❑ the transfer or obligation was to an insider;
- ❑ the debtor retained possession or control of the property transferred after the transfer;
- ❑ the transfer or obligation was concealed;
- ❑ before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
- ❑ the transfer was of substantially all the debtor's assets;
- ❑ the debtor absconded;
- ❑ the debtor removed or concealed assets;
- ❑ 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;
- ❑ the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- ❑ the transfer occurred shortly before or shortly after a substantial debt was incurred; and
- ❑ the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

# CLAIM MECHANICS



- ❑ Must file a lawsuit asserting fraudulent transfer claim
- ❑ Can sue the debtor on the actual debt claim and also assert fraudulent transfer claims against recipient of property/funds at the same time
- ❑ Often assert debt claims first, litigate to judgment, and then begin unearthing fraudulent transfer evidence in post-judgment discovery process
- ❑ Can use the broad scope of post-judgment discovery to build a fraudulent transfer case
- ❑ Often a question of intent and a question of sufficiency of value or consideration exchanged, both of which are or can be fact intensive
- ❑ Not a criminal proceeding. Not necessarily a crime for a debtor to move assets around or restructure corporate holdings



# Bernard L. Madoff Investment Securities LLC



# MADOFF FRAUDULENT TRANSFER LAWSUITS



- Irving Picard , Trustee, appointed by bankruptcy court, in the BLMIS BK
- Has filed hundreds of CIVIL lawsuits, including many asserting fraudulent transfer claims, also known as avoidance or claw back actions
- Sought recovery of hundreds of millions from insiders, including Bernie's family members who Trustee claimed used the BLMIS as their own personal piggy bank – e.g., Ruth Madoff (wife) settled for \$45M.



# What can you do?



# DO YOUR DUE DILIGENCE



- Know where assets (and liabilities) are held, who owns them
  - Essential to determine creditworthiness
  - Important for collection purposes
- Verify information on credit application, financials
- Secure personal guaranties
- Watch out for corporate guaranties
- Ask questions, follow up with customers

# CONCLUSION



- The best practice: know who you're doing business with at all stages of the relationship
- Continue to investigate and keep updated information on your customers, assets and their corporate structures
- Avoid the “Shell Game” all together!



# THANK YOU!



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