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Chapter 129

Fraudulent Transfer

*by Alexander B. Lees**

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I. IN GENERAL

§ 129:1 Scope note

This chapter explores litigation under New York's fraudulent transfer statute, found in Article 10 of the Debtor & Creditor Law (often referred to as the "DCL"). New York's law in this area is at a crossroads: in December 2019, the State overhauled its statute entirely and enacted the Uniform Voidable Transactions Act (or the "UVTA"), effectuating the first modernization of New York's fraudulent transfer law in nearly a century and bringing New York law into conformity with that of nearly every other state after decades of divergence. The new statute (referred to in this chapter as the "new DCL") took effect on April 4, 2020, and applies to transactions that occur after that date. The former statute (referred to here as the "old DCL") still will apply to transactions that occurred before the effective date of the new act. Under the old legislation, transactions could be challenged up to six years after they occurred (and where a discovery rule applied, possibly even longer), which means that the old DCL will continue to be relevant for some time as challenges to older transactions are pursued. This chapter therefore focuses principally on the new legislation, but highlights significant areas where the old act, if applicable, might call for a different analysis, standard, or outcome.

After explaining some commonly used terms and phrases in fraudulent transfer law,[1] the chapter begins by addressing strategic considerations that a practitioner must confront when bringing[2] or defending against[3] a fraudulent transfer claim. These considerations include identifying and understanding the specific transaction to be challenged, starting the process of locating and hiring expert witnesses, assessing the availability and meaning of contemporaneous market evidence, addressing the possibility of lawsuits by other plaintiffs seeking to challenge the same transaction, and thinking about possible alternatives to a fraudulent transfer claim (such as filing a bankruptcy petition).

The chapter next provides context for New York's fraudulent transfer statute. It discusses the new DCL's legislative history and relationship to the previous model act on which the old DCL was based.[4] The chapter also discusses the relationship between New York's law, on one hand, and that of other jurisdictions—including other states that have enacted similar statutes[5] and the U.S. Bankruptcy Code[6]—on the other hand. Because of these relationships, case law developed in other states and in bankruptcy cases often is relevant to understanding New York's statute and the principles underlying it. (Just as a practitioner is advised to research and be mindful of the law of other jurisdictions, this chapter will reference authorities from other states and the federal courts throughout.)

The chapter then turns to the essential components of fraudulent transfer litigation: the theories of liability that can be sued upon,[7] who can bring a claim,[8] and who can be subject to liability,[9] remedies that are available to a successful plaintiff,[10] and defenses that can be asserted.[11] The chapter also covers procedural issues that affect fraudulent transfer claims,[12] including conflicts-

[Section 129:1]

[1]See § 129:2.

[2]See § 129:3.

[3]See § 129:4.

[4]See § 129:5.

[5]See § 129:6.

[6]See § 129:7.

[7]See §§ 129:8 to 129:17.

[8]See § 129:18.

[9]See § 129:19.

[10]See §§ 129:20 to 129:25.

[11]See §§ 129:26 to 129:33.

[12]See §§ 129:34 to 129:37.

of-law considerations,[13] the timeliness of claims,[14] pleading standards,[15] and burdens of proof.[16]

The chapter next addresses some of the customary methods of proving fraudulent transfer claims and defenses.[17] It covers such topics as the use of circumstantial evidence,[18] the role of expert testimony[19] (which is especially important in this area of the law), and market data.[20] The chapter also discusses ways that a prospective fraudulent transfer defendant can develop an evidentiary record before engaging in a transaction to mitigate future litigation risk.[21]

The chapter then considers "special cases" of fraudulent transfer claims—types of transactions or circumstances that tend to arise frequently and as to which special principles or rules of thumb have developed.[22] Such special cases include transfers to repay or secure existing debts,[23] dividends and distributions,[24] leveraged buyouts,[25] Ponzi schemes,[26] and foreclosures.[27]

The chapter concludes with practice aids. These include a discovery guide,[28] pleading and proof checklists,[29] and proposed jury instructions.[30]

§ 129:2 Terminology

Fraudulent transfer law is centuries old and well developed.[1] As a result, a specialized lingo has arisen, which is used

[13]See § 129:34.

[14]See § 129:35.

[15]See § 129:36.

[16]See § 129:37.

[17]See § 129:40.

[18]See § 129:39.

[19]See §§ 129:39 to 129:41.

[20]See § 129:41.

[21]See §§ 129:42 to 129:45.

[22]See §§ 129:45 to 129:49.

[23]See § 129:46.

[24]See § 129:47.

[25]See § 129:48.

[26]See § 129:49.

[27]See § 129:50.

[28]See § 129:53.

[29]See §§ 129:51 to 129:52.

[30]See § 129:54.

[Section 129:2]

[1]See § 129:5.

throughout the relevant authorities, as well as this chapter. Some key terms are discussed here, at the outset.

Names and relationships of parties. In every fraudulent transfer fact pattern, a creditor is owed payment from the debtor, and the debtor has transferred property (or incurred an obligation) to another, which allegedly renders the debtor less capable of paying the creditor what it is owed. The plaintiff in a fraudulent transfer action must be a creditor of the debtor/transferor.[2] And while the debtor's conduct in transferring property (or incurring a new obligation) is the subject of challenge, the principal defendant is not the debtor itself, but rather the one to which property was transferred (or an obligation was incurred)—the so-called "transferee" or "obligee."[3] The debtor/transferor can be named as a defendant for purposes of obtaining a limited set of remedies.[4] But the central relief that the plaintiff will seek—unwinding a transaction—must be sought against a transferee or obligee. It is that person who will have to surrender property or an obligation if the plaintiff succeeds on a fraudulent transfer claim.

Types of claims. Fraudulent transfer claims come in several varieties. First, there are the kinds referred to as "actual fraud" or "actual-intent" claims. They require proof that the debtor acted with *intent* to injure creditors.[5] Second, there are claims premised on theories of "constructive fraud," which do not require proof of the debtor's intent to harm creditors, but instead rely on objective criteria: namely, that the debtor was in a precarious financial position and transferred property or incurred an obligation for less than a reasonably equivalent exchange of consideration.[6] A third variety of claim is "insider preference," which requires proof that an insolvent debtor repaid or secured a debt owed to an insider (like a major shareholder, or a family member).[7] Insider preference claims could be considered a species of "constructive fraud" claims, although this chapter treats them as their own variety.

Avoidance. Fraudulent transfer law provides a remedy of "avoidance" of transactions, which essentially means treating the transactions as though they did not occur. Alternative uses include "unwinding," "voiding," "disregarding," or "clawing back" transfers. These are terms of art. A judgment under New York

[2]See § 129:3.

[3]See § 129:4.

[4]See §§ 129:4, 129:20 to 129:25.

[5]See § 129:8.

[6]See §§ 129:9 to 129:14.

[7]See § 129:15.

law that a transaction was made or obligation was incurred in fraud of creditors does not mean that the transfer or obligation was void *ab initio*, or that it is disregarded for all purposes and from the point of view of all parties. To the contrary, avoidance means that the successful plaintiff—and only the successful plaintiff—can disregard or ignore a transfer or obligation, and only to the extent of its underlying right to payment from the debtor. Beyond this, a transfer or obligation is still good and enforceable against all other parties.[8]

Names of statutes. Most states, including New York, have adopted a model law governing fraudulent transfer claims. Different jurisdictions have adopted different versions of the model law, and New York itself has recently switched to a new version. The original model act, dating to 1918, is known as the Uniform Fraudulent Conveyance Act, usually abbreviated as "UFCA." The next version of the model act, dating to 1984, is known as the Uniform Fraudulent Transfer Act, usually abbreviated as "UFTA." And the most recent version of the model act, published in 2014, is known as the Uniform Voidable Transaction Act or the "UVTA."[9]

New York's fraudulent transfer law is found in Article 10 of the Debtor & Creditor Law, often abbreviated as the "DCL." It was recently revised, as New York scuttled the UFCA in favor of the UVTA. New York's former version of the statute, which applies to transactions that occur before April 4, 2020, is referred to throughout this chapter as the "old DCL" or "old Debtor & Creditor Law." The State's new version of the statute, which applies to transaction that occur on or after April 4, 2020, is referred to throughout this chapter as the "new DCL" or "new Debtor & Creditor Law."[10] This is the author's terminology, adopted to distinguish between the two versions of New York's statute for purposes of this chapter; it is not necessarily a usage that will be found in other authorities.

Other defined terms. Other significant terms for purposes of fraudulent transfer law are defined in section 270 of the new DCL. This includes, for example, who constitutes an "insider" of the debtor, what constitutes a "transfer," who is a "creditor" of a debtor, and so forth.[11] Some of the more important definitions are discussed in this chapter as they become relevant, but it is beyond the scope of this chapter to discuss every defined term in section 270. A practitioner should be mindful of consulting sec-

[8]See § 129:16.

[9]See § 129:5.

[10]See § 129:5.

[11]New Debt. & Cred. Law § 270.

tion 270 inasmuch as the application of a definition in that section might be the subject of dispute in any given case. In addition, sections 271 and 272 of the new DCL, respectively, define "insolvency" and "value." These significant terms are discussed at length in §§ 129:10 and 129:12 of this chapter.[12]

§ 129:3 Preliminary considerations for plaintiffs

A plaintiff seeking to pursue a fraudulent transfer claim usually knows that its debtor has undertaken a transaction of some kind that feels injurious or unfair to creditors. But before suing, it is imperative for the prospective plaintiff to try to understand the details of the transaction at issue, to the extent feasible before discovery. This will aid the plaintiff in understanding who received the assets in question or their value, and therefore who can be a defendant.

A full understanding of the transaction also is necessary to determining if it is possible to articulate a cogent theory of "creditor injury" that is cognizable under fraudulent transfer law. In some cases, this will be straightforward, such as where the transaction in question is a simple purchase and sale in which the debtor received less than adequate consideration. In other cases, identifying the theory of injury can be considerably more complicated. Many fraudulent transfer cases arise in the context of complex financial restructurings or convoluted corporate transactions. In such a situation, it can be difficult to discern just when and how creditors were made worse off, if at all. The potential plaintiff must scrutinize the transaction and identify with precision the extent to which the debtor parted with value in the transaction or incurred an obligation it did not previously have, and what consideration (if any) the debtor received.

Not every transaction that affects the rights of creditors necessarily is subject to challenge under fraudulent transfer law. For example, if the transaction involved the debtor's securing or repaying an existing debt owed to a non-insider, other creditors may face a lower prospect of recovery, but they are unlikely to have a viable fraudulent transfer claim. Likewise, where the debtor is a holding company that owns stock of an operating subsidiary, and the subsidiary squanders assets or incurs substantial new obligations, this may reduce the value of the debtor's equity holding and therefore its ability to satisfy its own liabilities in full. But unless there is a reason to disregard corporate separateness, there is no basis to conclude that the holding company engaged in a transfer or incurred a new debt—only its subsidiary did. On the other hand, while one transaction alone may not

[12] See §§ 129:10, 129:12.

injure creditors, when it is considered in conjunction with substantially simultaneous or related transactions, all the steps taken together may have had a deleterious effect. There might be grounds to "collapse" the multiple steps and have the factfinder focus on the net economic effect of the many transactions, as is frequently done in challenges to leveraged buyouts or complex reorganizations.[1] A plaintiff needs to understand the details of what occurred to frame its case properly.

In addition to identifying a theory of injury[2] and the potential defendants,[3] a plaintiff also must determine which theories of recovery to pursue. Constructive fraud theories[4] usually are the first to be considered, since they tend to be easier to prove (as they rely on objective criteria, and not the debtor's intent), and because insolvency almost always is a specter whenever fraudulent transfer claims are being discussed. If the plaintiff can identify other questionable circumstances surrounding the transaction—such as when the transaction involved insider dealing,[5] was outside the ordinary course of business, or was concealed—a claim for actual-intent fraud may become plausible.[6] And if the transaction involved paying or securing a debt owed to an insider like a major shareholder, a theory of insider-preference would be appropriate.[7] If the plaintiff's underlying claim against the debtor arose after the transaction to be challenged, however, the menu of possible theories will be shorter. A so-called "future creditor" can pursue actual-intent fraud claims as well as constructive fraud claims based on the debtor's unreasonably small assets and inability to pay debts; but it cannot pursue constructive fraud claims based on the debtor's balance-sheet insolvency or claims of insider-preference.

A plaintiff similarly will need to consider what relief to request.[8] The final goal usually is to obtain a money judgment[9] for the value of the transferred assets, which can be applied to pay the creditor's underlying claim. This may not be justified, however, where the plaintiff's underlying claim against the debtor will not mature until well into the future; some alternative and more

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[Section 129:3]

[1]See, e.g., Chapter 109, "Private Equity" (§§ 109:1 et seq.)

[2]See §§ 129:8 to 129:17.

[3]See § 129:19.

[4]See § 129:9.

[5]See § 129:15.

[6]See § 129:8.

[7]See § 129:15.

[8]See §§ 129:20 to 129:25.

[9]See § 129:20.

creative remedy may have to be explored, such as imposing a constructive trust or escrowing funds. Further, in some circumstances, a plaintiff may perceive a risk that the defendant or the debtor will engage in additional conduct that will thwart a creditor's collection efforts. When that is the case, a plaintiff will want to look to statutory provisions authorizing preliminary injunctive relief,[10] including an asset freeze against the debtor or the defendant (or both), and in drastic scenarios, the appointment of a receiver.[11]

In all events, a plaintiff should consider sourcing and retaining expert witnesses early in the case.[12] Expert testimony is paramount in the fraudulent transfer context, particularly with respect to valuation of assets,[13] which is relevant to determining if the debtor received sufficient consideration and whether it was insolvent in the balance-sheet sense. While a debtor's books and records may give the accounting value or tax basis for its assets, fraudulent transfer law requires a fair-value analysis, which usually entails expert analysis. Claims premised on the debtor's unreasonably small assets or inability to pay debts also often require experts to opine on the reasonableness of the debtor's financial projections at the time they were prepared. Actual-intent fraud claims[14] may require an expert to opine on these same issues, since insufficient consideration and insolvency (of some form) are badges of fraud.[15] A plaintiff pursuing an actual-intent claim also may seek expert testimony on whether a transaction fits within the norms of corporate custom and practice and debtor-creditor relations. Engaging experts early in the case will help a plaintiff assess the quality of its claim and understand which theories of recovery are most promising and which are more challenging. In addition, experts will help the plaintiff determine what kinds of information to request in discovery, given the business of the debtor and any industry-specific factors that may affect the relevant analyses.

In conjunction with hiring experts, a prospective plaintiff will need to be cognizant of available market evidence that could be probative of value or insolvency—for example, securities prices, the results of any market test, the financial health of comparable companies similar to the debtor, contemporaneous opinions or

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[10]See § 129:22.

[11]See § 129:21.

[12]See Chapter 33, "Selection of Experts, Expert Disclosure and the Pretrial Exclusion of Expert Testimony" (§§ 33:1 et seq).

[13]See generally Chapter 111, "Valuing a Business" (§§ 111:1 et seq.).

[14]See Chapter 128, "Fraud" (§§ 128:1 et seq.).

[15]See § 129:39.

analyses of advisors involved in the challenged transaction, and so forth.[16] If a plaintiff's theory of value or insolvency is consistent with the market data, this will provide comfort. But if not, the plaintiff will have to begin constructing theories and explanations as to why the market evidence cannot be trusted, such as because critical information was concealed from market participants. Experts can assist in developing the market evidence component.[17]

A prospective plaintiff also will need to be cognizant of procedural issues that could affect the litigation, including whether its claim arises under New York's new fraudulent transfer statute (which applies only to transactions that take place after April 4, 2020), or under the former version of the DCL.[18] While the substantive principles underlying the two versions of the DCL are largely the same, which statute applies could have important implications for timeliness issues: the new statute has a four-year statute of repose for most claims, while the old statute was governed by a six-year statute of limitations.[19] Similarly, a plaintiff will want to prepare for possible arguments that its claim does not arise under New York law at all. This can be especially relevant for cases involving foreign or cross-border transactions, since many foreign jurisdictions do not recognize theories of constructive fraudulent transfer. If New York law does not apply, the plaintiff's available theories of relief may be limited.

Finally, a plaintiff should know the extent to which other parties in interest can affect the litigation landscape. A debtor often has multiple creditors and where one seeks to avoid a transfer, another may be able to challenge the same transaction on the same basis. This could be a benefit: the plaintiff can solicit other parties to join the lawsuit, gain "power in numbers," and thus convey to the finder of fact the extent of the creditor injury that the debtor has caused. This also could be a burden. If the debtor has limited assets—which usually is the case in the fraudulent transfer context—a race to the courthouse can ensue. The obvious mechanism for overcoming the difficulty of creditor competi-

[16]See § 129:41.

[17]See § 129:40.

[18]Throughout this chapter, New York's former fraudulent transfer statute (applicable to transactions occurring before April 4, 2020) and its new fraudulent transfer statute (applicable to transactions occurring on or after April 4, 2020) are referred to as the "old DCL" and the "new DCL," respectively. See § 129:5.

[19]See § 129:35.

tion is a bankruptcy case.[20] Creditors might band together to start an involuntary proceeding to ensure a fairer distribution of assets, including anything recovered in a fraudulent transfer lawsuit; or a debtor might initiate a case voluntarily to stem the flow of litigation. In either event, the commencement of a bankruptcy case vests the trustee (or other estate fiduciary) with the exclusive authority to pursue—and settle—fraudulent transfer claims on behalf of all creditors and requires the proceeds to be distributed fairly. A potential plaintiff will no longer need to race to judgment, but it also will lose direct control over the litigation and settlement. And it likely will have to share the proceeds of a judgment ratably with other creditors, which could result in the creditor receiving less than a full satisfaction of its underlying claim.

§ 129:4 Preliminary considerations for defendants

For a prospective defendant, the defense to fraudulent transfer liability sometimes can begin before the challenged transaction even takes place. This can occur when the prospective defendant controls the debtor and orchestrates a transaction that may come under attack; this also can occur when an outsider deals with a company that it knows is facing distress and whose transactions therefore will garner the attention of creditors. In these situations, the prospective defendant can take some steps to mitigate fraudulent transfer liability, such as employing respected advisors to assess (and perhaps give a contemporaneous opinion on) the fairness of the transaction to the debtor or the solvency of the debtor.[1] Especially when an insider is involved in the transaction, ensuring that the debtor has some level of independence[2]—an unaffiliated director, or its own legal or financial advisors—also will help diffuse allegations of insider-dealing, which otherwise tend to support inferences of actual fraudulent intent and can undermine a fact finder's confidence in the fairness of any consideration exchanged. And whenever feasible and appropriate, conducting a robust market test[3] for the asset the debtor is to buy or sell, and then transacting at or above the price discovered through that process, will go a long way toward undercutting an argument that the debtor did not receive a reasonably equivalent value. All these steps help create a contemporaneous record that

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[20]See generally Chapter 60, "Effect of Bankruptcy Proceedings on Pending Litigation and Judgments" (§§ 60:1 et seq.).

[Section 129:4]

[1]See § 129:42.

[2]See § 129:43.

[3]See § 129:44.

the parties were acting in good faith and that creditors were not injured.

Beyond this, the considerations for a fraudulent transfer defendant are largely the same as for a plaintiff.[4] Like a plaintiff, a defendant will want to understand all the details and mechanics of the transaction under attack and determine whether it is possible to argue that creditors did not suffer a cognizable injury, including whether the debtor received any consideration. The defendant also will want to explore time-bar defenses, and possible arguments that the more favorable law of another jurisdiction should apply.[5] And depending on the theory of relief pursued by the plaintiff, the defendant should consult the list of available statutory and non-statutory defenses. In most cases, demonstrating that reasonably equivalent value[6] was provided to the debtor in some form will strongly rebut a claim (and possibly eliminate liability), regardless of the theory of relief; similarly, demonstrating that the debtor was in a healthy financial condition will undermine a plaintiff's challenge.

For these reasons, much like a plaintiff, a defendant will want to consider hiring experts early in the case to opine on issues of valuation[7] and financial condition.[8] This will aid the defendant not only in preparing to rebut and challenge the plaintiff's experts, but also in putting forward affirmative defenses. Further, in many cases, the defendant will have no control over the debtor and so will need to take discovery of the debtor, just like the plaintiff. Experts can assist in identifying information that should be requested, including materials relating to the debtor's financial condition. Finally, just like a plaintiff in a fraudulent transfer case, a defendant will need to assess whatever contemporaneous market evidence is available that sheds light on such issues as valuation and solvency.[9] The defendant, perhaps with the assistance of experts, then will need to develop arguments either that the plaintiff's case cannot be reconciled with real-time market data, or that the market data is not trustworthy for some reason.

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[4]See § 129:3.

[5]See § 129:34.

[6]See § 129:28.

[7]See Chapter 111, "Valuing a Business" (§§ 111:1 et seq.).

[8]See Chapter 33, "Selection of Experts, Expert Disclosure and the Pretrial Exclusion of Expert Testimony" (§§ 33:1 et seq.).

[9]See § 129:41.