

And Now for Some Good News About Fraudulent Transfers

When a fraudulent transfer is found, it can be good news for your judgment-enforcement case: The documentation of the debtor's transfer of assets becomes the very evidence needed to recover those assets.

By Joe H. Dickerson

"Judgment for the plaintiff," declares the judge. "This court is adjourned." Down comes the gavel: Bang!

If you are the plaintiff in a civil action to restore your crucial assets, those are sweet sounds. They sound like justice. They sound like vindication. They also sound like closure, but they are not.

Most people don't realize that a whopping 80% of winning plaintiffs never succeed in collecting their civil judgments. While courts can do their part to "make you whole" on paper, courts are not collection agencies, and losing defendants have a huge bag of tricks from which to draw in hampering your attempts to collect what's rightfully yours. Worse, the usual approach to collections — involving legal interrogatories, debtors exams, subpoenas duces tecum, and so on — often only serves to cost you more money while giving the debtor more time to hide assets and cover his tracks.

Business people and professionals usually operate with a good, working definition of fraud: Intentionally inducing someone to act against his or her interests through lies, misrepresentation or concealment. There is, however, a different and less-well-known type of fraud called "fraudulent conveyance" or "fraudulent transfer." If you find yourself a creditor in the collections process, you need to know about it because discovering and undoing fraudulent transfers can serve you well.

The "Other" Fraud

When a debtor tries to hinder, delay or defraud a creditor by shifting assets to others for less than fair value, that is fraudulent transfer by definition. A common example is when a debtor transfers the title to his home into his wife's name to keep it from creditors. Does it matter that he transfers assets to a spouse? No, nor does it matter if he transfers assets to a child, a cousin, a business partner, a trust or a straw entity. It does not even matter that the transfer takes place before a court renders a judgment, so long as the intent to hinder, delay or defraud was present.

The assets to look for may include almost any real or personal property: cash, bank accounts, investments, jewelry, furniture, collections of all kinds, herds of animals, houses, land, water or mineral rights, indus-

trial inventories and equipment, cars, boats, aircraft and so on. It can include the liquidated value of loans owed by others to the debtor. It can even include intellectual property like patents, copyrights or trademarks. Some exemptions exist; among them are retirement funds, tools of the debtor's trade and homestead exemptions that vary from state to state.

If you find yourself a creditor in the collections process, you need to know about fraudulent transfers because discovering and undoing them can serve you well.

When a fraudulent transfer is found, it can be good news for your judgment-enforcement case: The documentation of the debtor's transfer of assets becomes the very evidence needed to recover those assets. When you show the judge that the transfer was a sham, the judge can simply void the transaction, enjoin any subsequent transfers, and you can seize it immediately. The legal precedents for handling fraudulent transfer date from the 17th century. (See sidebar)

The Four Tests

There are four tests for fraudulent transfer:

Test 1: Subsequent Creditors

If a debtor entered into an agreement with you at a time when he was insolvent and the transfer was for less than fair value, the transaction was fraudulent.

Test 2: Existing Creditor

If, after your claim arose, the debtor became insolvent and transferred property for less than fair value to an insider such as a spouse or a busi-

The Badges of Fraud

The nine “Badges of Fraud” are well established in law. Simply put, these behaviors are outward evidence or indicators of fraud. They provide great latitude for a judge’s discretion in determining if fraudulent transfer has taken place.

- **Badge 1:** Lack of consideration for the conveyance. Any valid contract requires consideration that meets the test of law, which means that the consideration must have value a reasonable person could agree to. For instance, conveying a million-dollar property in exchange for \$10,000 doesn’t pass the “sniff” test of reasonability.
- **Badge 2:** Transfer of the debtor’s entire estate. A person in good health and a rational state of mind doesn’t ordinarily dump everything he owns at once. To do so without a valid reason other than avoiding a creditor’s claim constitutes fraud.
- **Badge 3:** Relationship between transferor and transferee. Any unusual “insider” transfer of assets may be suspect: wife to husband, child to parent, president to vice president, parent company to subsidiary, and so on. (Estate-planning or tax-planning or inheritance transfers may be “normal” when not done under pending or threatened litigation.)
- **Badge 4:** Pendency or threat of litigation. This is a key provision, and it may apply from any time the debtor realizes he may become party to litigation, including the date of contract.
- **Badge 5:** Secrecy or hurried transaction. This may seem obvious, but if a debtor takes actions to cover the tracks of his financial dealings, or if he transfers assets without going through what a reasonable person would consider the normal steps or normal precautions, it may indicate fraud.

- **Badge 6:** Insolvency or indebtedness of transferor. If the debtor makes himself insolvent, it may indicate fraud.
- **Badge 7:** Departure from the usual method of business. If the debtor abruptly starts doing business with radically different or inappropriate customers or suppliers or changes his policies regarding payables or receivables, it may indicate fraud.
- **Badge 8:** Retention by the debtor of possession. Suppose a debtor transfers his vacation home to his child, but leaves his own furniture in it and continues to use it for his own vacations? This indicates fraud.
- **Badge 9:** Reservation of benefit to the transferor. If the debtor continues to use the vacation home from 8, above, to entertain friends and clients or attempts to borrow money by offering the vacation home as collateral, it may indicate fraud.

Badges 1, 3, 5 and 6 are all prominent issues in the first three tests cited in the article. Most of the other badges are aimed at discerning the intent of the transferor.

The landmark case on fraudulent transfer law is *Twyne’s Case*¹ from 1601. The Uniform Law Commission adopted the Uniform Fraudulent Conveyance Act in 1918. After changes in the Uniform Commercial Code and the Bankruptcy Reform Act of 1978, the Commission adopted the Uniform Fraudulent Transfer Act in 1984, and it has subsequently been adopted by at least 40 states; the other states and U.S. jurisdictions have similar law in place. A state-court judgment will have to be domesticated in each state before you can seize assets there.

¹ *Twyne’s Case*, 3 Coke 80b, 76 Eng. Rep. 809 (Star Chamber 1601).

ness partner who should have known about his insolvency, the transaction was fraudulent.

Test 3: No Consideration

If the debtor entered into the transaction with you without receiving reasonable value in return, or if the debtor had insufficient assets to enter into the transaction or was unable to make payments on time, the transaction was fraudulent.

NOTE: These first three tests require judges to adhere strictly to facts as proved in court to determine if fraudulent transfer has occurred.

Test 4: Circumstantial Evidence

If the debtor undertook his obligation to you or transferred any assets with the intent to subvert your rights as a creditor, that transaction was fraudulent.

NOTE: The fourth test uses the “Badges of Fraud” (see sidebar), which gives judges great latitude in determining if a fraudulent transfer has been made. It may apply even if the first three tests are inconclusive.

The Best Approach

In our practice, we find that the best approach to collecting judgments is to investigate the debtor’s finances in depth before engaging in the legal process of interrogatories, debtors exams, subpoenas and so on. When a fraudulent transfer is found, it is good news. The transfer documents what assets the judgment debtor has attempted to hide and how. The transfer provides proof of the Badges of Fraud, and having that proof in hand leads to expedient settlement. **abfj**



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