FRADULENT TRANSFERS IN THE CONTEXT OF ASSET PROTECTION

There is a great deal of similarity between the Bankruptcy Code and the UFTA when it comes to fraudulent transfers.[2] Because of this similarity, courts have held that cases decided under either law can be relied on as precedent.[3]

A. Types of Fraudulent Transfers

The UFTA defines two distinct types of transfers that may be set aside: 1) ones with the actual intent to stifle creditors in their attempts to satisfy claims, and 2) ones that constructively lead to the same goal.[4]

Before a transfer may be "fraudulent," it first must be a "transfer." UFTA defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of alien or other encumbrance,"[5] whether made before or after the creditor's claim arose.[6]

Almost every modification of an interest in an asset falls under this vast definition. Collier defines a "transfer" for these purposes as any action which diminishes the value of a debtor's property.[7] Consequently, if a debtor conveys fully encumbered property (i.e., property with no equity), it will not be treated as a transfer.[8] Similarly, if the transferred property is covered by an available exemption, it cannot be a fraudulent transfer because it does not diminish what the creditor may receive.[9]

This broad definition of "transfer" means that in addition to transactions that are transfers on their face, certain other events may be treated as transfers: inaction, waiving defenses, terminating a lease, extending a loan, making a tax election, withdrawing cash from a deposit account, granting a security interest in property, converting nonexempt assets into exempt assets (even though the transaction can be characterized as a debtor transferring assets to herself), perfecting a security interest or obtaining a lien, and renting of property for less than fair market value.

Beatrice must be very careful when she takes steps to protect her home and investment account. Assigning these assets to a limited liability company or an irrevocable trust or amending the terms of an existing LLC agreement or trust would constitute a "transfer" if such actions make it more difficult for the bank to collect.

Debtors frequently transfer of assets to LLCs, but not always with the desired consequences. In a recent bankruptcy case, *In re Dealers Agency Services, Inc.,* the debtor transferred substantially all his assets to a newly formed LLC that was controlled by his then-girlfriend, later his wife, at a time when a lawsuit was pending against him. The court held that the transfer was voidable as a fraudulent transfer.[10]

Procedurally, a creditor asserting a fraudulent transfer claim bears the burden of proof as to each element of the claim.[11] The standard of proof on a claim for constructive fraud is "preponderance of the evidence." For actual intent, the standard used may either be "clear and

convincing evidence," as required by the California courts, or "preponderance of the evidence" as required by the Ninth Circuit.[12]

1. Actual Intent

If the debtor transfers assets with the "actual intent" to obstruct his creditors, the transfer is voidable. The UFTA and the Bankruptcy Code both provide that a transfer made by a debtor is fraudulent as to a creditor if the debtor made the transfer with the "actual intent to hinder, delay or defraud" any creditor of the debtor.[13] A creditor need only show one of these factors; courts have set aside a transfer even if the debtor only intended to delay paying the debtor's creditors, as opposed to avoid paying creditors altogether.[14]

Proving a debtor's subjective "actual intent" [15] to defraud a creditor is much easier said than done, because it involves entering the mind of the transferor. As a result, legislatures and courts have developed lists of "badges of fraud" as factors that would lead to certain inferences about the nature of a transaction. The UFTA includes a non-exhaustive list of "badges of fraud"[16] which are illustrative and do not create a presumption of fraud.

The badges of fraud include: (1) whether there was a transfer or obligation to an insider; (2) whether the debtor retained control or possession of the transferred property; (3) whether the transfer was disclosed or concealed; (4) whether the debtor was sued or threatened with a suit at the time of the transfer; (5) whether the debtor removed or concealed assets; or (6) whether the transfer involved substantially all of the debtor's assets.[17] In practice, transfers for less than fair market value or transfers that make the debtor insolvent are the most probative badges of fraud.

A transfer of property into an entity that is controlled by the transferor is usually a probative badge of fraud. In *South Side Nat. Bank in St. Louis v. Winfield Financial Services Corp.*, the debtor transferred 15 real estate properties to a corporation controlled by the debtor. The court found the following badges of fraud: the corporation was controlled by the individual debtor, the transfers were made in anticipation of suit or execution by a bank, that all of the debtor's property was transferred to a related corporation, and the debtor was insolvent after the transfers. The transfers were voided.[18]

The often cited case of *Hilborn v. Soale* illustrates a last-minute transfer. Mr. and Mrs. Soale were joint owners of a piece of real property when Ms. Hilborn obtained a judgment against Mr. Soale. On the following day, and before the judgment was entered so as to become a lien against the property, Mr. Soale drafted a deed that purported to transfer to his wife all of his interest in the property. The court upheld the trial court ruling setting aside the transfer.[19]

In another seminal case, *Lander v. Beers*, Mr. Beers had purchased several lots of land in Oakland with his own money. To keep these lots insulated from the reach of his creditors, however, he transferred them to his daughter. The daughter then "leased" the lots back to her father to manage. The court voided the transfers holding that the transfer was made for the sole purpose of defrauding Mr. Beers' creditors.[20]

Again, these factors are simply tools that a court can look to in order to determine the actual intent of the debtor. They are considerations for courts to consider as indicative of whether the debtor indeed had the intent to hinder, delay, or defraud his creditors.

The actual intent test looks to the debtor's intent to defraud "any" creditor. The modifier "any" is very important. A creditor seeking to set aside a conveyance as a fraudulent transfer need not show that the debtor intended to defraud him. The creditor need only show that at the time of the transfer the debtor sought to defraud some specific creditor. However, for fraudulent transfer purposes, the world of creditors is divided into three classes: present creditors, future creditors, and future potential creditors.

California Code of Civil Procedure Section 3439.04 provides that the transfer may be deemed fraudulent "whether the creditor's claim arises before or after the transfer was made." This would seem to imply that any creditor, present or future, would be protected by the UFTA; which conflicts with the common law concept of the free alienability of property by its owner.

While the UFTA clearly applies to present creditors,[21] the distinction between a future creditor and a future potential creditor is not as clear. A future creditor is defined as a creditor whose claim arises after the transfer in question, but where there was a foreseeable connection between the creditor and the debtor at the time of the transfer. For example, a doctor's pool of patients is comprised of future creditors of the doctor, as there is a foreseeable connection, but even in this example the foreseeability will vary for each specific doctor as each doctor has a different likelihood of being sued. The homeowner is the future creditor of the building contractor, because there is a foreseeable connection.

A future potential or contingent creditor is one whose claim arises after the transfer, but there was no foreseeable connection between the creditor and the debtor at the time of the transfer. For example, someone the debtor may run over tomorrow is a future potential creditor today.

Generally, a future creditor is one who holds a contingent, unliquidated or unmatured claim against the debtor. A transfer is fraudulent as to a future creditor if there is fraudulent intent directed at the creditor at the time of the transfer. For example, if a debtor is about to default on a personal guaranty, and transfers her assets in anticipation of such default, the holder of the guarantee is a future creditor and the transfer is made with intent to defraud the creditor. Thus, for Beatrice, the bank is a present creditor if she transfers her assets today, but a future creditor if she had transferred her assets before her son had defaulted on the bank loan.

A future creditor must not only be foreseeable at the time of the transfer of assets, the timing of such creditor's claim must be proximate to the time of the transfer. In one case, the court defined the term "future creditor" as on whose claim is "reasonably foreseen as arising in the immediate future."[22]

Future potential creditors are distinguished from future creditors by the fact that there is no intent to defraud a particular future potential creditor. For example, a debtor is worried that he has insufficient automobile insurance coverage and transfers his assets. Those who may in the future be run over by the debtor are future potential creditors, as there is no intent to run over a specific person.

Because the UFTA is commonly held to apply only to future creditors, but not to future potential creditors, asset protection planning should focus on future potential creditors, if possible. This generally means that planning ahead of time cannot be challenged under the "actual intent" test.

To summarize, only a present or future creditor may bring a fraudulent transfer action under the actual intent test. Future potential creditors do not have standing to bring a fraudulent transfer action. It is also impossible for the debtor to have actual intent to defraud a person of whose existence the debtor is not aware.

Thus, the word "any" is somewhat misleading, because it does not really mean "any." The debtor must have a specific creditor in mind to form actual intent.

If Beatrice engages in any asset protection planning, she would be acting when the bank already has a claim against her. By itself, this badge of fraud would likely be insufficient to establish that her intent was to engage in asset protection planning. The bank would also have to hone down on how she transferred her assets, did she receive fair market value consideration, who were the assets transferred to. Beatrice would try to show that her actions are motivated by a desire to engage in estate planning, investment planning or succession planning.

2. Constructively Fraudulent Transfers

The most common type of fraudulent transfer, is one that is "constructively" fraudulent. Under both the Bankruptcy Code and the UFTA, a constructive fraudulent transfer may be established by satisfying two elements: 1) the debtor does not receive a "reasonably equivalent value" in exchange for the money or other consideration transferred to the transferee, and 2) the debtor fails one of three "financial condition" tests.[23] Unless the creditor proves both the value and the financial condition elements, it will be unable to prevail on a constructive fraudulent transfer claim.[24]

a. The Reasonably Equivalent Value

A court will first consider whether a debtor received "value" in exchange for the transfer of property from the viewpoint of a creditor with a viable state law claim.[25] "Value" for the purposes of Bankruptcy Code Section 548, "means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."[26] The UFTA defines "value" as that which is "given for a transfer ... if, in exchange for the transfer ..., property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise

than in the ordinary course of the promisor's business to furnish support to the debtor or to a relative of the debtor ..."[27]

The focus is on whether the debtor received property or satisfaction of a present or antecedent debt. The analysis is "directed at what the debtor surrendered and what the debtor received irrespective of what any third party may have gained or lost."[28] The debtor can even receive value indirectly.[29]

Further, "reasonably equivalent" does not mean that a dollar-for-dollar match is necessary.[30] The focus is on the reasonableness of the transfer in light of market conditions. Fair market values at the time of the transfer are critically important in evaluating this element. More importantly, a court will consider events and circumstances as they existed on the date of the transfer, not as they appear in hindsight.[31]

For example, in *Filip v. Bucurenciu*, the court found that the transfer of a property valued by an appraiser at $530,000 for no money down and a $400,000 promissory note was not for fair market value and therefore a fraudulent transfer.[32] Contrast that with *Cambridge Electronics Corp. v. MGA Electronics, Inc.*, where the court held that a corporation received a reasonably equivalent value in exchange for a $428,410.45 payment made to its sole shareholder's father, in the form of a dollar-for-dollar reduction of a $500,000 debt owed on a loan received from the father.[33] Accordingly, transaction values need not be exact, but they need be reasonable given the circumstances.

Often, financially distressed debtors are forced to sell their assets, such as in a foreclosure sale or other bargain sales. In such circumstances, assets are frequently sold for less than the hypothetical fair market value. The Supreme Court held that in such circumstances the consideration received in a forced sale constitutes equivalent value,[34] provided that there is an opportunity for competitive bidding. For example, the consideration received in a foreclosure sale will be deemed sufficient only if the sale was open to public bidding.

The use of partnerships and LLCs becomes of great importance in reducing the amount of acceptable fair market value. Because partnership interests are frequently discounted for lack of control and lack of marketability, the debtor may be able to sell a partnership interest at a discount, and still satisfy the adequate fair market value test. However, to comply with the above referenced Supreme Court ruling, it may be advisable to disclose the sale in a local newspaper, thus, theoretically, opening the sale of the interest to public bidding.

It is very important to document the sufficiency of value at the time of the transfer. Likewise, it is important to establish that both the valuation and the transfer were achieved at arm's length. This author has found that when a debtor transfers assets for adequate consideration, even if the transfer is to a family member, establishing the fraud element is exceedingly difficult.

b. The Financial Condition Factor

In order to prove a constructive fraudulent transfer, the creditor must also prove one of the following:

1. The debtor 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 the transaction;

2. The debtor intended to incur, or believed or reasonably should have believed that he would incur debts beyond his ability to pay as they became due; or

3. The debtor was insolvent at the time of the transfer, or the debtor became insolvent as a result of the transfer.

Of these three, solvency (scenario #3) is most often used because it is the most objective. Importantly, the debtor's solvency is presumed; the burden of proving insolvency rests on the creditor.[35]

Under both the Bankruptcy Code and the UFTA, a debtor will be deemed insolvent if "the sum of the debtor's debts is greater than all of the debtor's assets" at a fair valuation.[36] Fair value as a term, however, remains undefined in both sources of law. Accordingly, the usual starting point for determining the sufficiency of assets is the debtor's balance sheet at the time of the transfer in question, particularly if the balance sheet is prepared according to generally accepted accounting principles and consistently applied.[37] This debtor's balance sheet, however, is not conclusive on the issue of solvency.

In determining solvency, assets are usually valued from the standpoint of the creditor – what the creditor would realize from these assets. Liabilities are valued from the standpoint of the debtor – what the debtor is expected to pay. Thus, for example, in determining the debtor's assets, anticipated income streams, foreseeable capital sources, and loans must be taken into account. This means that a business must be valued as a going concern, accounting for future anticipated cash flows. Value is usually determined by assuming that the debtor would have a reasonable amount of time to sell his or her assets. Consequently, no liquidation discounts are applied. This is obviously favorable to the debtor who wants to establish solvency. Liabilities must be discounted to reflect the probability that they will mature and accrue. Because valuations frequent rely on expert testimony, the value of a contemporaneous appraisal cannot be overstressed.

Certain types of assets, however, cannot be taken into account. These include exempt assets, and other unreachable assets, such as when the debtor is a beneficiary of a discretionary or a spendthrift trust. Other assets that cannot be counted are assets that are transferred to defraud, hinder or delay a creditor, and assets that are outside of the jurisdiction of the court – such as assets located in foreign jurisdictions. Finally, assets that have been transferred to entities (partnerships and limited liability companies) must be valued by applying valuation discounts.[38]

Alternatively, the creditor may prove that the debtor was left with unreasonably small assets or, put another way, undercapitalized, as a result of the transfer (scenario #1). Similar to the evaluation of reasonable equivalence above, the determination of unreasonably small capital is not made based upon hindsight. Instead, the determination focuses solely on what was known or could have been known at the time of the transfer. [39] These are purely factual questions determined on a case-by-case basis. Generally, the creditor's experts will rely upon the debtor's cash flow, projected sales, profit margins, various financial ratios, and evidence of outside events such as a lender's willingness to fund a company.[40] The "critical question," according to the leading case *Moody v. Security Pacific Business Credit, Inc.*, is whether the debtor's cash flow projections at the time of the transaction were reasonable. This is tested under an objective standard.[41]

Finally, a creditor can satisfy the financial condition test of a claim for constructive fraudulent transfer by establishing that, at the time of the transfer, the debtor intended to incur or believed it would incur debts beyond its ability to pay as they came due (scenario #2). This is commonly referred to as the "equitable insolvency test."[42] The test measures whether the debtor, as a going concern, would reasonably have been able to pay its debts after the transfer.[43] "Reasonableness" is often measured through the use of cash flow projections and other forward looking sources of evidence.[44]

While not immediately apparent from the language of the California Civil Code, it is not enough for a creditor to show that an insolvent debtor made a transfer for less than full and adequate consideration. There must be some connection between the insolvency and the transfer. Usually, this means that there must be more to these two elements (transfer and insolvency) than their proximity in time.

For example, in *Credit Managers Association of South. Cal. v. Federal Co*., 629 F. Supp. 175, 184 (1985), a transfer by the debtor for less than full consideration followed shortly by a loss of a big customer and a labor strike that made the debtor insolvent was not fraudulent. The court focused on the fact that the imminent insolvency was not anticipated at the time of the transfer. Thus, an unforeseen event that makes the debtor insolvent may be sufficient to rebut the constructive fraud test.

Beatrice should therefore try to transfer her assets into a limited liability company, in exchange for a membership interest, or to sell her assets to an irrevocable trust, possibly for a promissory note. Both types of transactions are commonly used estate planning techniques, and both are for fair market value.

B. Common Defenses in Fraudulent Transfer Cases

1. Good Faith

A showing of good faith and reasonably equivalent value can easily defeat a creditor's action. A transfer is not voidable against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee.[45] This means that even if the debtor acted in bad faith and intended to commit actual fraud, the creditor or the bankruptcy trustee will not

be able to void the transfer to a person who purchased in "good faith." In order for a purchaser to be protected from the application of the UFTA under the good faith exemption, the purchaser must 1) take the property in good faith and 2) for a reasonably equivalent value.[46] Transferees cannot simply rely on what is known or not known to them. They have a duty to investigate, if certain facts put them on notice.

In the seminal case *Chichester v. Mason*, the Bergmans deeded some lots of real property to their friends, the Masons, in order to hold the property in secret trust for the Bergmans. The court held that this was done primarily to defraud the Bergmans' creditors. The court voided the transaction finding that this transfer was consummated with the Masons' knowledge of the fraudulent intent of the Bergmans. The court further noted that even if there had been consideration, the transfer would still be voidable because of the Bergmans were fully aware of the fraudulent nature of the transaction.[47]

2. Statute of Limitations

Both the UFTA and the Bankruptcy Code have statutes of limitations for bringing these types of claims. Under the Bankruptcy Code, there is a two-year statute of limitations.[48] In California, however, the statute is four years from the time the transfer is made.[49] There is a further wrinkle in this area: fraudulent transfers may also be attacked by invoking laws other than the UFTA, including common law fraud claims. Thus, the California codification of the UFTA is not the only statute of limitations applicable to actions to set aside a fraudulent transfer. The Code of Civil Procedure provides a three-year statute of limitations for actions for relief on the ground of fraud or mistake, which does not begin to run until a plaintiff obtains a judgment on the underlying debt. [50]

Some states have enacted special statutes of limitations for fraudulent transfers involving trusts. For example, Nevada has a two year statute on the transfer of assets to a spendthrift trust.[51]

III. <u>REMEDIES AVAILABLE TO CREDITORS</u>

Creditors have several remedies available to them in the case of a fraudulent transfer under California law. These include: 1) avoidance of the transfer (Note: the transfer is voidable, not void), 2) an attachment or other provisional remedy against the transferred assets or proceeds, 3) an injunction against the debtor, the transferee, or both, against further disposition of the transferred assets or proceeds, and 4) an appointment of a receiver to take charge of the asset or its proceeds.[52] Further, a court is allowed to grant "any other relief required by the circumstances."[53]

While the most common remedy is the avoidance of the transfer, it is critical to note that the transaction is voidable only as to the creditors, and then to the extent necessary to satisfy their claims.[54] Consequently, a transfer or an obligation is not voidable against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee.[55]

There are, of course, limitations to this on the part of the transferee. A purchaser from a fraudulent grantee who has notice of the fraud or who has paid no consideration takes title subject to the infirmities of his or her grantor's title.[56] Accordingly, the transfer he receives may be set aside at the demand of the first grantor's creditors and the property seized in satisfaction of their demand.[57] The UFTA specifically deals with transfers of personal property without immediate delivery followed by actual and continued change of possession. Such a transfer is fraudulent and voidable as to purchasers in good faith subsequent to the transfer.[58]

There are also some important differences in the recovery schemes of both the Bankruptcy Code and the UFTA, but they lie outside the scope of this article.[59]

IV. CONSEQUENCES FOR ENGAGING IN FRAUDULENT TRANSFER FOR DEBTOR AND RELATED PARTIES

So what can happen then, to Beatrice, if she does try to fraudulently transfer her home and investment account into an asset protection structure?

A. Criminal Penalties for Debtor

In California, any party to a fraudulent transfer or related transaction may be guilty of a misdemeanor.[60] Similarly, a debtor who fraudulently removes his or her property from the state or fraudulently sells or conceals it with intent to defraud his or her creditors may be guilty of a misdemeanor.[61] Persons who engage in a fraudulent transfer while there is an action pending against them, or a judgment has been rendered for the recovery of property, are also penalized.[62]

In practice this course of action is very difficult to pursue because the debtor's intent, established through the badges of fraud, has to be proven using the "beyond a reasonable doubt" standard.

B. Third-Party Advisor Liability

1. Attorneys

An attorney must never advise or assist a client in breaking the law. There is a considerable grey area as to what may constitute a fraudulent transfer in any given case, but that does not mean that an attorney should not be careful about his advice in asset protection planning. If a debtor's transfer is fraudulent, the attorney may face sanctions for violating his professional code of ethics. The California Rules of Professional Conduct state that an attorney "shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid."[63] The American Bar Association Model Rules of Professional Conduct similarly echoes that a lawyer "shall not counsel a client to engage, or assist a client, in conduct the lawyer knows or reasonably should know is criminal or fraudulent."[64]

Many lawyers choose to forego asset protection engagements because of the perceived liability for the advisor. Lawyers can find themselves in trouble under two separate legal theories: aiding and abetting and conspiracy.

There are several cases that have held attorneys liable for "aiding and abetting" a client in a fraudulent transfer. For example, *In re Harwell*,[65] the attorney allowed the client to hold his fortune in the attorney's trust account, and the lawyer then made disbursements per the client's directions. However, the general principle followed by the courts has been the one enunciated in *Reynolds v. Schrock*,[66] which holds that an attorney will not be liable for "aiding and abetting" a fraudulent transfer unless the attorney acts outside the scope of the lawyer-client relationship.

Under conspiracy theory, a lawyer may be liable for conspiring to engage in a fraudulent transfer when (i) he conspires to engage in a fraudulent transfer, and (ii) the traditional remedies are inadequate (the catchall provision).[67] Conspiracy should generally be difficult to prove, because it is often difficult to determine at the time of a transfer whether the transfer would later be deemed a fraudulent transfer.

In the few cases on this subject, it is fairly clear that courts often confuse a "fraudulent transfer" with "fraud," or at least equate the two, and treat a fraudulent transfer as a tort, and not as an *in rem* action. The same conclusion was reached in a recent U.S. District Court opinion, as well as by the Fifth Circuit in the bankruptcy context and by the Florida Supreme Court.[68]

There is also a risk of criminal liability. Because the California Penal Code specifically singles out fraudulent transfers as illegal, an attorney could be implicated in such a prosecution. At the federal level, attorneys also expose themselves to criminal liability including bankruptcy crimes under Title 18 for using the bankruptcy system "to further or conceal a scheme or artifice to defraud."[69] Lawyers also face criminal prosecution for knowingly and fraudulently concealing property belonging to the debtor or his bankruptcy estate.[70]

In practice, the author of this article has never come across a case involving a debtor's attorney being targeted by the creditor, except for cases when the attorney takes a very pro-active role in concealing or hiding debtor's assets.

2. Accountants

The same federal crimes would apply to accountants who would "further" the concealment of these assets. Further, similar statutes condemn the knowing concealment of assets from the IRS, or a conservator or liquidating agent of a financial institution (e.g., the FDIC).[71] In terms of professional liability, the California law would prohibit an accountant from engaging in fraud without some disciplinary action.[72]

V. <u>PRACTICE POINTERS ON MAKING LEGAL TRANSFERS</u>

Beatrice is in a considerable bind. She wants to keep her assets but runs the risk of engaging in a fraudulent transfer if she attempts to protect her assets at the last minute. The following are important guidelines for engaging in this type of a transaction.

A. ACT SOONER RATHER THAN LATER

In general, it is critical to understand one thing about making legal transfers: act quickly and before there are any creditors in the offing. For Beatrice it may be too late; she is already on notice, and therefore a creditor may be able to prove that any transfer she made was asset protection motivated.

For debtors who are acting at the last minute (which unfortunately is the majority of debtors), it becomes important to rebut a possible fraudulent transfer argument by establishing a different purpose for the transfer. Beatrice may be pursuing estate planning, wealth diversification, succession planning, and the timing could be a simple coincidence. These arguments do not guarantee success, but might make it more difficult to establish a fraudulent transfer and possibly place Beatrice in a better negotiating position.

B. BE TRANSPARENT

Asset protection should not be an undercover project. The goal is not to hide or conceal. Of course, there is no reason to advertise what the client is engaging in to protect his assets. Nevertheless, if recording the transfer documents is required, do it. The courts will consider all of these acts and it will certainly bolster the good faith defense.

C. DEAL AT ARM'S LENGTH

The transfer must be properly documented, as it would be in any arm's-length transaction. While this is common sense to any law practitioner, in practice it is often difficult to make the client take all the appropriate steps to complete the transfer. Often, in its initial analysis, a creditor will have nothing else to go on, other than the formalities of a transaction. If the transaction/transfer looks arm's length, the inquiry may stop there.

D. ENSURE ADEQUATE CONSIDERATION

The "reasonably equivalent" standard outlined above does not require that there be an exact monetary exchange for the assets that are being transferred. Nevertheless, it key to ensure that any such consideration would warrant someone reviewing the transaction to infer that there was some bargained for consideration and that this is not some sort of a sham transfer. Fair market value and the adequacy of consideration should be established by appraisal, if the client is willing to pay for that.

Any transfer undertaken for fair market value is difficult to challenge as a fraudulent transfer. It is both the most important badge of fraud, and completely negates a constructively fraudulent transfer. Consequently, transfers to legal entities in exchange for an interest in the entity is preferable to a transfer to an irrevocable trust. A transfer in exchange for an entity interest is by definition for fair market value; transfers into trusts are usually gratuitous.

E. RELY ON PROFESSIONAL ADVICE

Reliance on the advice of counsel is a common way to mitigate the "badges of fraud." If one seeks the advice or opinion of an attorney prior to the transfer, and is advised that the proposed transfer is not fraudulent, that supports a sound legal position. After all, the debtor is establishing that there is a lack of intent to defraud someone else—his creditors. If he is retaining a lawyer before he acts, it reflects well on his intentions.

Such reliance, however, will not be a complete shield. A debtor will be held liable if it is determined that the attorney gave his opinion based on a limited set of facts, and that the debtor's reliance was unreasonable given the circumstances.

Also, because the debtor's financial condition is among the more important inquiries under the actual intent or the constructive fraud tests, an accountant should be involved early on. It is good practice to have the client's accountant prepare a balance sheet, on a fair market value basis, to help establish solvency at the time of the transfer.

VI. CONCLUSION

The cases cited above support the belief that the law of fraudulent transfers is the 800-pound gorilla of asset protection planning. However, the case law does not paint a full picture. A creditor is unlikely to challenge a transfer if he is not certain of victory. Cases that are settled prior to trial or are never pursued by a creditor are generally not publicly available. Consequently, the published opinions represent a skewed statistical sample.

Beatrice has two simple options. She can choose to do nothing, either because she is worried of running afoul of the fraudulent transfer laws or for any other reason. If she does nothing and the bank gets a judgment against her, she will lose all her assets.

Beatrice can also choose to take steps to protect her assets. The bank may challenge her actions as a fraudulent transfer. After all, litigation is expensive and time consuming. If the bank challenges, it may prevail. A fraudulent transfer claim is never a slam dunk. If the bank prevails, it may be able to unwind the transfer and reach the transferred assets. Maybe assets were transferred into some black hole of asset protection planning. Even if, after all these maybes, the bank reaches her assets, she would be in exactly the same position had she done nothing. She simply loses her assets. Beatrice may have no downside to trying to protect her assets, other than the transaction cost.

Analyzing fraudulent transfers in the context of asset protection requires more than simply knowing the statutes and the case law. It requires a keen eye for the practical consequences.

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[1] 13 Eliz., Chapter 5 (1571).
[2] There are some differences between the California and federal fraudulent transfer laws, including recovery schemes and statutes of limitations.
[3] *Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir. 2008).
[4] Cal. Civ. Code §§ 3439.09.04-05.
[5] Cal. Civ. Code § 3439.01.

[6] Cal. Civ. Code § 3439.04.
[7] Collier on Bankruptcy (15th ed. 1993).
[8] Cal. Civ. Code §3439.01(a)(1). *Mehrtash v. ATA Mehrtash*, 93 Cal. App. 4th 75 (2001) (the transfer of real property subject to encumbrances, including judgment liens, could not be set aside as a fraudulent transfer, as the creditor could not show how she was injured).
[9] Cal. Civ. Code § 3439.01(a)(2). *Reddy v. Gonzalez*, 8 Cal. App. 4th 118, 122 (1992) (homestead property not subject to fraudulent transfer laws).
[10] *In re Dealers Agency Services, Inc.,* 380 B.R. 608, 622 (Bankr. M.D.Fla. 2007).
[11] *Neumeyer v. Crown Funding Corp.*, 56 Cal. App. 3d 178, 183 (1976).
[12] *Reddy v. Gonzales*, 8 Cal. App. 4th 118, 123 (1992) (holding that standard is clear and convincing evidence); and *Gill v. Stern* (*In re Stern*), 345 F.3d 1036, 1042-43 (9th Cir. 2003) (holding that the "preponderance of the evidence standard" applies to both constructive and intentional fraudulent transfer claims).
[13] *See* 11 USC § 548 and Cal. Civ. Code § 3439.04.
[14] *Shapiro v. Wilgus*, 287 U.S. 348, 353-56 (1932); *Consove v. Cohen (In re Roco Corp.)*, 701 F.2d 947, 984 (1st Cir. 1983).
[15] *Plotkin v. Pomona Valley Imports, Inc. (In re Cohen)*, 199 B.R. 709, 716 (B.A.P. 9th Cir. 1996) ("The focus in the inquiry into actual intent is on the state of mind of the debtor").
[16] *Wyzard v. Goller*, 23 Cal. App. 4th 1183, 1191 (1994).
[17] Cal. Civ. Code §3439.04(b).
[18] *South Side Nat. Bank in St. Louis v. Winfield Financial Services Corp.*, 783 S.W.2d 140 (Mo. Ct. App. E.D. 1989).
[19] *Hilborn v. Soale*, 29 Cal. App. 309, 311 (1916).
[20] *Lander v. Beers*, 48 Cal. 546 (1874) (overruled in part on othergrounds by, *Crisman v. Lanterman*, 149 Cal. 647 (1906)).
[21] A present creditor is a creditor holding a matured claim. Thus, creditors who filed a lawsuit, received a judgment or were just run over by the debtor (and thus accrued a claim against the debtor) are present creditors.
[22] *Leopold v. Tuttle*, 549 A. 2d 151, 154 (Penn. 1988).
[23] *See* Cal. Civ. Code §§3439.04 (b)(1)-(2) and 3439.05.
[24] *Annod Corporation v. Hamilton & Samuels*, 100 Cal.App.4th 1286, 1294-95 (2002).
[25] *General Electric Capital Auto Lease, Inc. v. Broach (In re Lucas Dallas Inc.)*, 185 B.R. 801, 807-08 (B.A.P. 9th Cir. 1995) (*citing* Cal. Civ. Code § 3439.03 Assembly Comm. Cmt. p. 2 (1986)).
[26] 11 U.S.C. § 548(d)(2)(A).
[27] Cal. Civ. Code § 3439.03.
[28] *United Energy Corp. Wyle v. Ch Rider & Family,* 944 F.2d 589, 597 (9th Cir. 1991).
[29] *Id.*
[30] *Mellon Bank v. Official Comm. of Unsecured Creditors of R.M.L. (In re R.M.L., Inc)*, 92 F.3d 139, 145 (3d Cir. 1996).
[31] *Id.* at *155.*
[32] *Filip v. Bucurenciu*, 129 Cal.App.4th 825, 835 (2005).
[33] *Cambridge Electronics Corp. v. MGA Electronics, Inc*., 227 F.R.D. 313, 317 (C.D.Cal.2004).
[34] *In re BFP*, 511 U. S. 531, 545 (1994).
[35] *Neumeyer, supra,* 56 Cal. App. 3d at 190.
[36] Cal. Civ. Code § 3439.02(a); 11 U.S.C. § 101(32).
[37] *Kendall v. Sorani (In re Richmond Produce Co., Inc.)*, 151 B.R. 1012, 1019 (Bankr.N.D. Cal. 1993).
[38] Cal. Civ. Code § 3439.02.
[39] *Credit Managers Assoc. of Southern California v. The Federal Co.*, 629 F. Supp. 175, 184 (C.D. Cal. 1985).
[40] *Credit Managers*, *supra,* 629 F. Supp. at 183.
[41] *Moody v. Security Pacific Business Credit, Inc.*, 971 F.2d 1056 (3d Cir. 1992).
[42] *Moody*, *supra,* 971 F.2d at 1070.
[43] *Pajaro Dunes Rental Agency, Inc. v. Spitters (In re Pajaro Dunes Rental Agency, Inc.),* 174 B.R. 557, 593 (Bankr. N.D. Cal. 1994).
[44] *Pajaro Dunes,supra,* 174 B.R. at 593.
[45] Cal. Civ. Code § 3439.08(a).

[46] Cal. Civ. Code § 3439.08(a).
[47] *Chichester v. Mason*, 43 Cal.App.2d 577, 587 (1941).
[48] 11 U.S.C. § 548.
[49] Cal. Civ. Code § 3439.09(a).
[50] Cal. Code Civ. Proc., § 338(d).
[51] Nev. Rev. Stat. §166.170.
[52] Cal. Civ. Code § 3439.07-.09.
[53] *Id*.
[54] Cal. Civ. Code § 3439.08(a).
[55] *Id.*
[56] *Ballou v. Andrews Banking Co.*, 128 Cal. 562 (1900).
[57] *Id.*
[58] Cal. Civ. Code § 3440.
[59] Cal. Civ. Code § 3439.07 and 11 U.S.C. § 550(a).
[60] Cal. Penal Code § 531.
[61] Cal. Penal Code § 154.
[62] Cal. Pen. Code § 155.
[63] California Rule Prof. Resp. 3-210.
[64] ABA Model Rule 1.2(d).
[65] 414 B.R. 770 (M.D. Fla. 2009).
[66] 142 P.3d 1062 (Or. 2006).
[67] *Asarco LLC v. Americas Min. Corp*., No.1:07-CV00018, 2009 WL 2168778 (S.D. Tex. July 20, 2009).
[68] *Arena Dev. Group, LLC v. Naegele Communications, Inc.*, No. 06-2806 ADM/AJB, 2007 WL 2506431 (D. Minn. Aug. 30, 2007); *Mack v. Newton*, 737 F.2d 1343 (5th Cir. 1984); *Freeman v. First Union Nat'l Bank*, 865 So. 2d 1272 (Fla. 2004).
[69] 18 U.S.C. § 157 et seq.
[70] 18 U.S.C. § 152.
[71] *See* 26 U.S.C. § 7206 and 18 U.S.C. §1032.
[72] Cal. Bus. & Prof. Code § 5100(c).