II. Fraudulent Transfers Actions and Its Defenses

This section of the presentation will focus on fraudulent conveyances. Again, while the first strategy (and sometimes the only strategy) that a defense attorney learns is "stall, stall, stall" this strategy cannot be effectively employed in the United States Bankruptcy Court for the District of South Carolina (the "Bankruptcy Court"). At least this author has never been able to effectively employ this strategy in this Bankruptcy Court. Thus, this article will focus on other defenses to a fraudulent conveyance action.

First, to understand the defenses to a fraudulent conveyance action, one must know what the elements of the action are. Of course, the first defense will be challenging one of the elements. Thus, this article will first discuss the elements of a fraudulent conveyance action under Section 548 of the Bankruptcy Code (11 U.S.C. §548) while examining possible challenges to these elements. Also, in this section, we will discuss the recent amendments to the Bankruptcy Code to one of the elements relating to the time of the transfer.

Second, as it relates to defenses to a fraudulent conveyance action under the bankruptcy code, separate from the elements themselves, depending on the circumstances, one can challenge whether the plaintiff has the right to bring the action.

Third, because of the ability of a bankruptcy trustee to also use the South Carolina version of fraudulent conveyance law, referred to as the Statute of Elizabeth, this article will discuss the elements of this statute.

Fourth, the biggest affirmative defense used to challenge a fraudulent conveyance action under South Carolina state law is the statute of limitations. Recently, the South Carolina Supreme

Court has held that the statute of limitations does not apply to equitable actions. However, this article will discuss how this particular holding should not be applied to fraudulent conveyance litigation.

1. Elements required under Section 548

Section 548(a)(1) provides:

> 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 one year before the date of the filing of the petition, if the debtor voluntarily or involunatarily –
>
> (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
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> (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; or (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.

11 U.S.C. §548(a)(1). So, the plaintiff must show a (1) transfer, (2) of an interest of the debtor in property or any obligation incurred by the debtor, (3) made or incurred within one year of the filing of the petition, that was (4) either voluntary or involuntary. After the plaintiff shows these elements, he has two different ways to set aside the transfer. The plaintiff may show (5) the transfer was made with the actual intent to hinder delay or defraud a creditor or (6) the debtor received less than (6.1) reasonably equivalent value at a time when (6.2) the debtor was insolvent or made insolvent by the

transfer, or (6.3) the debtor would become insolvent because of a business or transaction to be engaged in or the debtor intended to incur or would incur debts beyond its ability to pay.

1.1. A Transfer

The term transfer, includes every method of disposing of or parting with property or possessions. *Hoecker v. United Bank of Boulder*, 476 F.2d 838, 840 (10th Cir. 1973). The transfer does not have to be made directly by the debtor, as long as one can connect the transfer to the debtor, either directly or indirectly. *Carmel v. River Bank Am. (In re FBN Food Services, Inc.)*, 185 B.R. 265, 272 *aff'd and remanded* 82 F. 3d 1387, *rehearing denied* (N.D.Ill 1995); *Matter of Clover Donut of White Plains Corp.*, 14 B.R. 205 (Bankr. S.D.N.Y. 1981). Nevertheless, a transfer needs to be made.

In addition to the usual transfers ordinarily thought of (deeding property, gifting property, selling property), the following non-exhaustive list of transfers have been the subject matter of fraudulent conveyance actions:

(A) Consignment of goods -- *In re Factory Tire Distributors*, Inc., 64 B.R. 335 (W.D. Pa. 1986).

(B) Church contributions -- *United States v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407 (8th Cir. 1996) *rehearing and suggestion for rehearing en banc* denied 89 F. 3d 494; *see also* 11 U.S.C. §548(a)(2).

(C) Judgments barring debtors from reasserting claims -- *In re Besing*, 981 F. 2d 1488 (5th Cir. 1993) (Prejudicial dismissal was for debtor's discovery abuse.).

(D) Transfers according to divorce decree, separation agreement, or marital property settlement -- *In re Lange*, 35 B.R. 579, 583 (Bankr. E.D. Mo. 1983).

(E) Foreclosures -- *In re Littleton*, 888 F.2d 90 *rehearing denied* 890 F.2d 1167 (11 Cir. 1989); *see also BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994) (holding that

pre-petition foreclosure sale cannot be set aside as a fraudulent conveyance if the state's foreclosure laws are complied with).

(F) Tax sales – *see Turner v. United States (In re Turner)*, Case No. 96-72938, Adv. Pro. No. 76-8319 (Judge Bishop) (finding that a tax sale of real property by the IRS cannot be set aside)

(G) Termination of lease -- *In re Ferris*, 415 F. Supp. 33, 39 (D.C. Okl. 1976); *In re Queen Ciry Grain, Inc.*, 51 B.R. 722 (Bankr. S.D. Ohio 1985).

(H) Leveraged buyouts -- *O'Donnel v. Royal Business Group (In re Oxford Homes, Inc.)*, 180 B.R. 1, 9 (Bankr. D. Me. 1995).

(I) Mortgage modifications -- *Matter of Venice Western Motel, Ltd.*, 67 B.R. 777, 780 (Bankr. M.D. Fla. 1986) (transfer had the net effect of increasing principle amount of loan).

While this list is quite expansive, there are some splits in the authority dealing with whether a transfer occurs in situations that one would ordinarily think a transfer did take place.

For example, the Fifth Circuit and the Seventh Circuit have both addressed the issue of whether a down payment on real property constituted a transfer for fraudulent conveyance purposes. The Fifth Circuit holds it did. *See In re McConnell*, 934 F.2d 662, 664 (5th Cir. 1991). The Seventh Circuit holds that it does not. *See In re Wey*, 854 F.2d 196, 199 (7th Cir. 1988).

Similarly, several courts have looked at whether the transfer of property from non-exempt property to exempt property constitutes a transfer that can be challenged as a fraudulent transfer. Some have held that it is not a transfer. See *Weissing v. Levine (In re Levine)*, 139 B.R. 551, 554 (Bankr. M.D. Fla. 1992). Others have held that it is a transfer. *See In re Beckman*, 104 B.R. 866 (Bankr. S.D. Ohio 1989); *In re Breuer*, 68 B.R. 48 (Bankr. N.D. Iowa 1985).

Lastly, even though several courts have held the termination of a lease could be a transfer, at least one court has held that the termination of a franchise-dealership agreement was not a transfer subject to being set aside as a fraudulent conveyance. *See Matter of Jermoo's Inc.*, 38 B.R. 197, 206 (Bankr. W.D. Wis. 1984).

Thus, while the issue of whether a transfer took place is normally not an issue, when the transaction being challenged is complex, this element could provide a defense to the action.

In addition, the BAPCPA has weighed in as it relates to one area of Section 548 by specifically making transfers to insiders under employment contracts, not in the ordinary course of business, subject to the constructive fraud provisions of § 548(a)(1)(B). See BAPCPA §1402. Because of its inclusion in the constructive fraud provision, the defendant can defend on the basis of a reasonably equivalent value being given for the transfer. Further, the application of § 548 to employment contracts is not delayed. Instead, this section is effective on the date of the enactment for cases filed on or after the date of the enactment. So, if a case was filed after the enactment of the BAPCPA, a plaintiff could challenge a transfer under an employment contract that occurred within two (2) years of the filing of the bankruptcy.

1.2. Interest of the debtor in property, or any obligation incurred by the debtor

An essential element of an action under this section is that the debtor must have had an interest in the property transferred. *Noland v. FRE, Inc. (In re Jackson)*, 105 B.R. 15, 16 (Bankr. S.D. Ohio 1989). Because the interest of the debtor in the property is an undefined term in the bankruptcy code, the court will generally look to state law to help define its parameters. *In re Hulm*, 738 F.2d 323, 326 (8th Cir. 1984), *cert. denied* 469 U.S. 990, 83 L. Ed. 2d 331, 105 S. Ct. 398

(1984); *Simpson v. Penner (In re Simpson)*, 36 F.3d 450 (5th Cir. 1994); *In re Dews*, 152 B.R. 982 (D. Colo. 1993); *Furr v. Reynolds (In re Reynolds)*, 151 B.R. 974 (Bankr. S.D. Fla. 1993); *Lowe v. Brajkovic (In re Brajkovic)*, 151 B.R. 402 (Bankr. W.D. Tex. 1993).

The battles are fought in two areas: (1) where the debtor owns legal title to a piece of property, and (2) where the debtor does not possess legal title but some equitable interest. When the former is the case, it is often the debtor who must sustain the burden of proof that while legal title may be vested in his or her name, de facto or equitable title belongs to the alleged transferee. For example, in the case of *In re Reynolds*, 151 B.R. 974 (Bankr. S.D. Fla. 1993), the debtor was the legal title holder to real estate. The court found however, that no fraudulent conveyance had taken place because the debtor did not have an interest in the property beyond the face of the document. The debtor successfully proved that he was the legal title holder of the property for the benefit of his son to allow him to obtain financing for the property, and that neither the debtor, nor the son, had ever considered the debtor to be the legal title holder.

Here, the idea would be to use either a resulting trust or a constructive trust as an effective defense to a fraudulent transfer. Constructive trusts result from fraud, bad faith, abuse of confidence or violation of fiduciary duty. *See Lollis v. Lollis*, 291 S.C. 525, 354 S.E.2d 559, 561 (1987); *Doe v. Roe*, 323 S.C. 445, 475 S.E.2d 783, 786 (Ct. App. 1996). Fraud is an essential element of constructive trust, although it need not be actual fraud. *See Whitmire v. Adams*, 273 S.C. 453, 257 S.E.2d 160, 163 (1979); *Doe v. Roe*, 323 S.C. 445, 475 S.E.2d 783, 786 (Ct. App. 1996). The term fraud in these cases means some "reprehensible conduct." *See Chapman v. Citizens and Southern National Bank of South Carolina*, 302 S.C. 469, 395 S.E.2d 446, 452 (Ct. App. 1990). Further, the

Trust is against the person or entity that engaged in the "reprehensible conduct." As stated in *Halbersberg v. Berry*,

> [a] constructive trust arises against one who by fraud, actual or constructive, by duress or abuse of confidence, by commission of a wrong or by any form of unconscionable conduct, artifice, concealment, or questionable means and against good conscience, either has obtained or holds the right to property which he ought not in equity and good conscience hold and enjoy.

Halsbersberg v. Berry, 302 S.C. 97, 394 S.E.2d 7, 13 (Ct. App. 1990). The idea would be for the transferree to show that title was only placed into the transferror's name because of some "reprehensible conduct" and the transfer of the property to the transferree was merely the transferor returning the property to the one against whom he had engaged in this fraud or otherwise unconscionable conduct.

A resulting trust is very different. To create a resulting trust, the transferee need only show that the money used to originally purchase the property was from him and not from the transferror. However, it must be shown that the money used for the purchase was not a loan. *Reed v. Reed*, 217 Ga 303, 122 S.E.2d 253, 259 (1961) (resulting trusts do not result when money used in purchase was a loan); *Tiller v. Owen*, 243 Va 176, 413 S.E.2d 51, 53 (1992) (funds used for purchase cannot be a loan to titled owner in order to create a resulting trust); *Pierce v. Harrison*, 199 Ga. 197, 33 S.E.2d 680, 684 (1945) (a person in whose favor a trust is claimed to result from the payment of purchase

money must pay the purchase money as his own, and if he merely advances it as a loan, no trust will result).[1]

Further, the resulting trust is created, if at all, at the time the purchase is made. *See Hodges v. Hodges*, 243 S.C. 299, 133 S.E.2d 816, 819 (1963). Someone, at the time of the purchase of property, that loans money for the purchase of the property, but does not sign the contract of sale, does not obligate himself to make payments in the future and signs no other documents binding him, does not have a resulting trust. *See Tiller v. Owens*, 243 Va. 176, 413 S.E.2d 51, 53 (1992).

While constructive trusts and resulting trusts could be defenses to fraudulent conveyance actions, they could also be used by the plaintiff in furtherance of setting aside the transfer. For example, if the debtor supplied the down payment for property but title was placed in the name of another, the plaintiff may allege that the debtor should be declared the true owner of the property under a resulting trust theory.

1.3. incurred within one year before the date of the filing .

Section 548 of the Bankruptcy Code provides the limitations period available to trustees and debtors-in-possession. The section provides that a trustee may avoid any transfer of an interest of the debtor that was made or incurred on or within one year before the date of the filing of the petition, if procured through fraudulent means of the debtor. 11 U.S.C. § 548(a)(1)(A).

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[1] Please note that while the loan may not be sufficient to allow the transferee to establish a resulting trust, it may be sufficient consideration to act as a defense, in whole or in part, to the fraudulent transfer allegation. See 11 U.S.C. 548(d)(2) (value includes satisfaction or securing of an antecedent debt).

The timing of the transfer, therefore, becomes exceedingly important. Obviously, from the language found in the statute, the object of Section 548 was to prevent prepetition transfers, not postpetition transfers. *See Consolidated Partners Inv. Co. v. Lake*, 152 B.R. 485, 490 (Bankr. N.D. Ohio 1993). Therefore, a transfer that occurs after the bankruptcy petition is filed is not covered under this statute. *Consolidated Partners Inc. Co. v. Lake*, 152 B.R. 485, 490 (Bankr. N.D. Ohio 1993); *Fisher v. First Union Mortgage Corp. (In re Fisher)*, 80 B.R. 58, 60 (Bankr. M.D.N.C. 1987); *Eisenberg v. Bank of New York (In re Sattler's Inc.)*, 73 B.R. 780, 790 (Bankr. S.D.N.Y. 1987).

In complex transactions, the specific date of the transfer could prove to be important. Generally, where a lien of some sort is granted as part of the transaction, the transfer is deemed to take place on the date the lien is perfected, provided it is done prior to the bankruptcy filing. *Tucker Oil Co., Inc. v. First State Bank of Crossett (In re Tucker Oil Co., Inc.)*, 55 B.R. 78, 81 (Bankr. D. Ark, 1985) *appeal decided* 64 B.R. 183 (Bankr. W.D. Ark. 1985). At the same time, a granting of a security interest to a preexisting creditor during the one year period, without receiving new consideration, will alter the entire transfer or debt to the latest transaction date. *Kelley v. Horner (In re Kelley)*, 7 B.R. 384, 388-89 (Bankr. D.S.D. 1980). In deed questions, the operative date is when the deed is recorded. *Gennet v. Docktor (In re Levy)*, 185 B.R. 378, 382 (Bankr. S.D. Fla. 1995). The obvious pattern is that the court will usually look to the date that actual title vests or the date on which the last significant part of the transfer took place. In other words, the transfer date is liberally construed to find coverage under the statute.

The BAPCPA amends this section of 548. Specifically, instead of a 1 year reach back period, the BAPCPA provides for a two year reach back period. See BAPCPA §1402. However, Section

1406 of the BAPCPA provides that this amendment to 548 from 1 year to 2 years, applies only to cases commenced under title 11 more than one year after the date of the enactment. So, Congress decided to delay this amendment an additional six months from when other parts of the BAPCPA will become effective.

<u>1.4. voluntarily or involuntarily</u>

By including these words in the main portion of 548, Congress established an interesting classification scheme. Please recall that Section 548 is split into two sections 548(a)(1)(A) actual intent to hinder delay or defraud and 548(a)(1)(B) received less than reasonably equivalent value in exchange. Transfers to be set aside can thus be classified as (a) voluntary with fraudulent intent, (b) voluntary without reasonably equivalent value, (c) involuntary with fraudulent intent and (d) involuntary without reasonably equivalent value.

Most people can understand categories (a), (b) and (d). With (a), the debtor voluntarily transfers his property to a transferee with the intent to hinder delay or defraud creditors. Similarly, with categories (b) and (d), so long as the transfer was without reasonably equivalent value, it does not matter whether the debtor voluntarily participated in the transfer. *See Kuhn v. Nance (In re Nance)*, 26 B.R. 105, 107 (Bankr. S.D. Ohio 1982); *Checkmate Stereo & Electronics, Ltd v. Pereira (In re Checkmate Stereo and Electronics, Ltd.)*, 9 B.R. 585, 617 (Bankr. E.D. N.Y. 1981) *aff'd* 21 B.R. 402 (Bankr. E.D.N.Y. 1981). In both of these cases, a trustee was applying §548(a)(1)(B), the less than reasonably equivalent value section. This second section of 548 is admittedly much more objective, and requires little testing of the debtor's motivations or mental state. But, these cases do not answer the question of whether the involuntariness referred to in the primary paragraph of §548

can be coupled with "actual intent," found in the first subparagraph, to create a rather interesting result.

As it relates to category (c), fraud, as a general rule, requires some type of intent on the part of the actor. In this area, the common law does recognize constructive fraud, but constructive fraud is just another way of proving intent, as mental intent is often very difficult to prove. The fact that involuntary actions can be set aside as a fraudulent act seems contrary to common sense. For example, let us say that a debtor owes a credit card company $50,000, but he also has $10,000 in equity in his house. Further, let us say that a debtor hates the credit card company so much that he stops paying the first mortgagor on his house with the actual intent to hinder, delay and defraud the credit card company. Because they are not paid, the first mortgagor forecloses and purchases the house at foreclosure sale for the amount of the debt. Armed with the debtor's statement that he acted with the actual intent to hinder, delay and defraud the credit card company, can a trustee bring an action under 548(a)(1) to set aside the transfer resulting from the foreclosure? Further, if the trustee is successful in getting the property back, does he just get the $10,000 in equity or does he take the property, free and clear of the first mortgagor's interest?

Please recall that when actions are successful under 548, Section 551 of the Bankruptcy Code states:

> Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

11 U.S.C. §551. Thus, when the Court orders the avoidance, the Court does so for the benefit of the estate, not for the benefit of the secured creditor.

In the case of *Dunes Hotel Associates v. Hyatt Corporation*, 245 B.R. 492 (D.S.C. 2000), the court addressed the voiding of a lease hold interest in property. The District Court makes it clear that the avoidance of the lease hold interest would be for the benefit of the estate, not other interested entities. Specifically, the court held that "an automatic consequence of avoidance, beyond its nullifying effect, is preservation of the lien or other interest that is avoided, and that the preserved interest automatically becomes part of the estate without recovery. **Thus, when a transfer is avoided, the interest which the transfer created becomes part of the estate without further ado.**" 245 B.R. at 503 (emphasis added). The secured lender took the property at the foreclosure sale, free and clear of its own lien. Wouldn't the estate obtain that same interest?

So, by including the phrase "voluntary and involuntary" in this section, Congress added the potential for an interesting twist to the types of activities that constitute fraudulent conveyances, and the question may someday be answered whether these words serve any purpose or modify in any way the actions that can constitute fraudulent behavior.

1.5. actual intent to hinder, delay or defraud a creditor

Actual intent does not need to be proven by direct evidence or by an admission. *Nakagawa v. Sergio, Inc. (In re Sergio, Inc.)*, 16 B.R. 898, 908 (Bankr. D. Hawaii 1981). There exists common circumstantial indicia of a fraudulent intent that can be used to prove actual intent. Such indicia are usually referred to as "badges of fraud" and include, but are not limited to: (1) actual or threatened litigation against the debtor; (2) purported transfers of all or substantially all of the debtor's property;

(3) insolvency or other unmanageable indebtedness on the part of the debtor; (4) a special relationship between the debtor and the transferee; and (5) retention by the debtor of property involved in putative transfer (i.e., reservation of benefits, control or dominion by the debtor -- *In re Warner*, 87 B.R. 199, *appeal dismissed* 94 B.R. 734 (M.D. Fla. 1988)); *see also Campbell v. Haddock (In re Haddock)*, 246 B.R. 810, 813 (stating that courts look at certain indicia to determine if there is an actual intent to defraud creditors: "the insolvency or indebtedness of the transferor, lack of consideration for the conveyance, relationship between the transferor and the transferee, the pendency or threat of litigation, secrecy or concealment, departure from the usual method of business, the transfer of the debtor's entire estate, the reservation of benefit to the transferor, and the retention by the debtor of possession of the property")*; Max Sugarman Funeral Home, Inc. v. A.D.B. Investors*, 926 F.2d 1248, 1254 (1st Cir. 1991), *on remand* 149 B.R. 274. Other badges of fraud that have been noted in categorical form include:(1) absconding with the proceeds of the transfer immediately after their receipt; (2) absence of consideration when the transferor and transferee know that outstanding creditors will not be paid; (3) a huge disparity in value between the property transferred and the consideration received; and (4) the fact that the debtor was the officer, agent, or creditor of the transferor. *Carmel v. River Bank Am. (In re FNB Food Services, Inc.)*, 185 B.R. 265, 275 (N.D. Ill. 1995), *affirmed after remanded* 82 F.3d 1387, *rehearing denied*. Still other cases have referred to additional badges of fraud: (1) the conveyance is concealed; (2) the transferee takes property in trust for the transferor and transferor remains in possession; and (3) the debtor deals with property as his own. *Nakagawa v. Sergio, Inc. (In re Sergio, Inc.)*, 16 B.R. 898, 908 (Bankr. D. Hawaii 1981).

These badges of fraud and other suspicious behavior must be considered as a whole. A trustee does not have to prove any one of these factors with any degree of certainty. The facts, as taken together, only need to lead to the conclusion that actual fraud existed. *Harman v. First Am. Bank of Md. (In re Jeffery Bigelow Design Group, Inc.)*, 956 F.2d 479, 483-84 (4th Cir. 1992). The test requires a subjective determination of the debtor's motivation. *Id*. The standard is that fraudulent intent exists where the trustee shows that the transferor acted under circumstances precluding any reasonable conclusion other than that the purpose of the transfer was fraudulent as to his creditors. *Lives Science Church of River Park v. Personette (In re Life Science Church of River Park)*, 34 B.R. 529, 534 (Bankr. N.D. Ind. 1983); *see also Hovis v. Powers Construction Co., Inc. (In re Hoffman Assocs., Inc.)*, C/A No. 90-02419, Adv. Pro. No. 91-8293 (Bankr. D. S.C. 4/25/95) (Judge Waites) (finding that where debtor made payments only to creditors who were insiders or to creditors who had obtained personal guarantees from insiders that the payments were made with the actual intent to defraud the debtor's other creditors).

Which parties must be shown to have intent to defraud is unclear. Certainly, the debtor/transferor must have the requisite intent, but some courts hold that the transferee must have the intent as well. *Stratton v. Equitable Bank*, 104 B.R. 713, 726 (D. Md. 1989), *aff'd* 912 F.2d 464 (4th Cir. 1989); *William B. Tanner Co v. United States (In re Business Systems, Inc.)*, 642 F.2d 200, 203 (6th Cir. 1981) (transferee does not have to return payments if transferee entered transaction in good faith without knowledge of intent to defraud creditors); *Prisbrey v. Noble*, 505 F.2d 170, 176 (10th Cir. 1974) (transferee had bonafide purchaser status which trumped rights of trustee). The apparent logic for this rule is simple. If a bona fide purchaser, without knowledge or intent to

defraud, takes the property for value, then he or she has paid what he or she believes to be fair consideration for the item, or, at the very least, the debtor has no hope of gaining a return on the transfer after the bankruptcy has passed. In these cases, the transferee must still show that the consideration paid was in an amount that he or she believed to be reasonable. *Id*. In truth, the rule appears to be that once the badges of fraud have been proven against the debtor, then the transferee is presumed to have a similar intent, and this intent can be overcome by showing that the transferee was a bona fide purchaser for value. If proven, then the transfer cannot be undone.

There is, however, a middle ground between the two rules and this middle ground appears to be codified in Section 548(c). This section and most recent cases hold that a transferee is protected from the fraudulent conveyance statute to the extent of the consideration given. *See Jimmy Swaggart Ministries v. Hays (In re Hannover Corp.)*, 310 F.3d 796 (5th Cir. 2002) (transferee protected to the extent of good faith value provided); *Orlick v. Kozyak (in re Financial Federated Title & Trust, Inc.)*, 309 F.3d 1325 (11th Cir. 2002) (commissions earned without knowledge of Ponzi scheme could be considered as received in good faith to the extent of value being given); *but see Meeks v. Red River Entertainment (In re Armstrong)*, 285 F3d 1092 (8th Cir. 2002) (gambling casino did not act in good faith). Of course, which of the three positions taken will depend upon the party asserting the argument. *Struve v. Khan (In re Mesa)*, 48 B.R. 208, 210 (Bankr. S.D. Fla. 1985). Under the presumption that the transferred item is always more valuable than the consideration paid, trustees will inevitably always argue that only the debtor's intent needs to be proven, as this test will grant the trustee the return of the entire item with no refund to the transferee; the transferee will always argue that both party's intent needs to be proven, because by keeping the property, the

transferee retains his benefit of the bargain; and finally, the most logical remedy, the one in the middle, will go unargued, but will be the source of many judicial opinions, and has been termed the good faith rule. *See Gill v. Maddalena (In re Maddalena)*, 176 B.R. 551, 555 (Bankr. C.D. Cal. 1995) (if transferee neither knew nor should have known of the fraudulent nature of the transfer, then transferee is entitled to retain the fraudulent transfer to the extent of the value given in the exchange; if transferee knowingly or recklessly participates in the fraudulent scheme, then he or she is not protected); *Burtrum v. Laughlin (In re Laughlin)*, 18 B.R. 778 (Bankr. W.D. Mo. 1982). In cases where the transferee's "good faith" is an issue or the subject of discussion, courts generally look for indicia of an arms-length transaction, or whether there are gross departures, to determine whether the transferee is entitled to any special treatment. *Bullard v. Aluminum Co. of America*, 468 F.2d 11, 13 (7th Cir. 1972); *First Nat. Bank of Dalton v. Browning Fufters, Inc. (In re Browning Tufters, Inc.)*, 3 B.R. 487, 490 (Bankr. N.D. Ga. 1980).

This added twist on the law makes the adequacy of consideration all that much more important, and in some cases, a necessary factor in proving a fraudulent conveyance case. *See Schaps v. Just Enough Corp. (In re Pinto Trucking Service, Inc.)*, 93 B.R. 379, 385 (Bankr. E.D. Pa. 1988) (even where debtor did become insolvent as a result of transfer, court would not conclude fraudulent conveyance where debtor received adequate and fair compensation for sale); *Seidle v. Van de Grift (In re 18th Ave. Development Corp.)*, 18 B.R. 904, 905 (Bankr. S.D. Fla. 1982) (evidence that transferor received a fair value was sufficient to show not a fraudulent conveyance). However, in most cases, unequal consideration will not in itself prove a fraudulent conveyance case. *See e.g., Guitierrez v. Lomas Mortgage (In re Gutierrez)*, 160 B.R. 788, 791 (Bankr. W.D. Tex. 1993)

(purchase at 70% of value is insufficient, without other badges of fraud, to prove fraudulent conveyance). And there are cases that hold that valuable consideration is not an affirmative defense to a fraudulent conveyance. *Steimetz v. Sorokin (In re Beechwood Medicenter of Flint)*, 23 B.R. 939, 942 (Bankr. E.D. Mich. 1982); *Loftis v. Minar (In re Montanino)*, 15 B.R. 307, 312 (Bankr. D.N.J. 1981) (sale to parents living in same home was perceived to be effort to defraud creditors, and therefore, revocable, regardless of adequacy of consideration). Upon review of the *Beechwood* case, the court had the facts of a preference case, and because of time limitations, it was trying to fit it into the fraudulent conveyance statute. The case does however stand for the proposition that, even if fair consideration is received, the transaction will be unwound where it is determined that the debtor was attempting to either prevent certain creditors from receiving what they would receive without the transfer, or the debtor was attempting to make the eventual receipt of those payments or property more difficult for one or more creditors. *Id*. at 311.

One of the hotly litigated issues and one of the acts that angers trustees and creditors alike is where a debtor transfers non-exempt assets into exempt assets. While some courts hold that these internal transfers are not transfers at all, the majority of the courts do. Those courts that get past the initial question are inevitably faced with the question of whether the transfer to exempt property is a badge of fraud in and of itself. Creditors and trustees are often disappointed to find that the answer is no. An overwhelming number of cases state that the trustee must go one step further and prove that the transfer was made to prevent, hinder or delay creditors from reaching the assets. *Fed. Savings & Loan Ins. Corp v. Holt (In re Holt)*, 894 F.2d 1005 (8th Cir. 1990); *Samore v. Breuer (In re Breuer)*, 68 B.R. 48 (Bankr. N.D. Iowa 1985); *Ernst v. O'Brien (In re O'Brien)*, 67 B.R. 317

(N.D. Iowa 1986); *Jaudson v. Levine (In re Levine)*, 40 B.R. 76 (Bankr. S.D. Fla. 1984); *Egan v. Oliver (In re Oliver)*, 38 B.R. 407 (Bankr. D. Mass. 1984). However, the additional proof necessary appears to be minimal. *Crews v. First Colony Life Ins. Co. (In re Barker)*, 168 B.R. 773, 778 (Bankr. M.D. Fla. 1994) (even though placing funds into annuities was sound investment strategy, evidence appeared to show that transfer was made in attempt to hinder creditor's attempt to obtain the items.).

6. lack of reasonably equivalent value in exchange

The old equitable adage that one must be equitable before one is generous found its home in Section 548(a)(1)(B). Basically one must show that the debtor received less than a reasonably equivalent value in exchange for the transfer and that some creditor was detrimentally effected.

6.1. received less than reasonably equivalent value

Obviously, in this phase of the test, the court is comparing what left the estate to what entered into the estate. *Southmark Corp. v. Riddle (In re Southmark Corp.*), 138 B.R. 820 (Bankr. N.D. Tex. 1992); *see Anderson v. Blair (In re Blair)*, Case No. 99-08835-W, Adv. Pro. No. 99-80410-W (Bankr. D. S.C. 6/27/00) (finding that reasonably equivalent value was given for the transfer of debtor's one-half interest in house to separated husband because the husband had transferred property to the debtor and assumed liabilities pursuant to a separation agreement which value was nearly identical to the debtor's one-half interest in house). Generally, the litmus test on this issue is -- as long as the unsecured creditors are no worse off because of the transfer, then the debtor received a reasonably equivalent value to that which left the estate because of the transfer. *Harman v. First Am. Bank of Md (In re Jeffrey Bigelow Design Group, Inc.)*, 956 F.2d 479, 484 (4th Cir. 1992). This

does not mean that the debtor needs to receive a dollar for dollar exchange in order to have been paid a "reasonably equivalent value." *Butler Aviaion Int'l v. Whyte (In re Fairchild Aircraft Corp.)*, 6 F.3d 1119, 1125-26 (5th Cir. 1993); *Southmark Corp. v. Riddle (In re Southmark Corp.)*, 138 B.R. 820, 829 (Bankr. N.D. Tex. 1992). There is no magic percentage of fair market value that needs to be achieved in order to constitute reasonably equal consideration. *Fargo Biltmore Motor Hotel Corp. v. Metropolitan Fed. Bank (In re Fargo Biltmore Motor Hotel Corp.)*, 49 B.R. 782, 788 (Bankr. D.N.D. 1985) (flat percentage basis approach is inappropriate, however, a good starting point with which to gauge a transfer's reasonableness). However, one line of cases holds that anything less than 70% of the value is not reasonably equal. *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 203 (5th Cir. 1980); *Thrifty Dutchman, Inc. v. Florida Supermarkets, Inc. (In re Thrifty Dutchman, Inc.)*, 97 B.R. 101, 108 (Bankr. S.D. Fla. 1988). In another case, *Misty Management Corp. v. Lockwood*, 539 F.2d 1205 (9th Cir. 1976), the court held that a transfer was for less than reasonably equivalent value even though the transfer was for over 70% of the collateral's value, where the dollar amount of the difference was $276,000. One court has stated that the relative percentage of fair market value[2] is but one factor to be compared along with good faith and the relative difference in amount paid compared to the fair market value. *Cooper v. Smith (In re Smith)*, 24 B.R. 19 (Bankr. W.D.N.C. 1982); disapproved of by *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 819 (7th Cir. 1988). Other courts follow the 70% rule only in cases of private sales. *Madrid v.*

[2] Note that fair market value is the standard barometer unless the property is transferred under a forced sale environment, in which case the value is liquidation value. *Hollar v. Myers (In re Hollar)*, 184 B.R. 243, 251 (Bankr. M.D.N.C. 1995).

Lawyers Title Ins. Corp. (In re Madrid), 725 F.2d 1197 (9th Cir. 1984). A final line of cases holds that courts must determine reasonably equivalent value on a case by case basis. *First Federal Savings & Loan Assn. of Bismark v. Hulm (In re Hulm)*, 738 F.2d 323, 327 (8th Cir.), *cert denied*, 469 U.S. 990 (1984).

While the court generally must look to the surrounding circumstances of the transaction to determine value, *Butler Avaiation Int'l v. Whyte (In re Fairchild Aircraft Corp.)*, 6 F.3d 1119, 1127 (5th Cir. 1993), it is improper for a court to consider sentimental value of the debtor or other similarly subjective criteria. *Official Comm. of Creditors v. Shearson Lehman Bros. Holdings (In re First Capital Holdings Corp.)*, 179 B.R. 902, 907 (Bankr. C.D. Cal. 1995). At the same time, a completely objective, mathematical standard does not apply either. A court should consider things such as whether indicia of an arms length transaction are present and other factors showing the actual fair market value of the property sold. *Cooper v. Aschley Comm., Inc. (In re Morris Communications NC, Inc.)*, 914 F.2d 458, 467 (4th Cir. 1990) (appearing to side with the *First Federal v. Hulm*, *supra*, line of cases).

The operative date is the value of property and consideration as of the date of transfer. *Robinson v. Taylor (In re Robinson)*, 80 B.R. 455, 460 (Bankr. D. Ill. 1987).

6.2 insolvent/small capital remaining/ debt incurred beyond ability to pay

Some courts hold that if the party attacking the transfer as being fraudulent meets the burden of proving that the consideration given was inadequate, the burden of the defense of the transferor's solvency, or the proof that one of the three subsections of § 548(a)(2)(B) exists, passes to the party seeking to uphold the transfer. *See e.g., Josual Slocum, Ltd. v. Boyle (In re Joshua Slocum, Ltd.*, 103

B.R. 610, 620 (Bankr. E.D. Pa. 1989). However, most cases place this burden on the trustee. *See e.g., Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.)*, 100 B.R. 127, 133 (Bankr. D. Mass. 1989).

6.2.1 Insolvency

Courts look to see whether a debtor is either insolvent at the time of the transfer or rendered insolvent as a result of the transfer, and either one will be sufficient to pass this portion of the analysis. *Enwotwen Indus., Inc. v. Brookstone Ltd. Partnership (In re Newtowne, Inc.)*, 157 B.R. 374, 378 (Bankr. S.D. Ohio 1993); *see Anderson v. Simchon (In re Southern Textile Knitters, Inc.)*, C/A No. 98-07203-W, Adv. Pro. No. 99-80026-W (Bankr. D. S.C. 7/28/00) (finding that Trustee's failure to show that debtor was insolvent following the transfers at issue was fatal to his cause of action under Section 548). To decide whether a debtor is insolvent, courts generally ask -- what would the buyer be willing to pay for the debtor's entire package of assets and liabilities? If the price is positive, the debtor is solvent; if the price is negative, the debtor is insolvent. *Covey v. Commercial National Bank of Peoria*, 960 F.2d 657, 660 (7th Cir. 1992). Courts look to the debtors balance sheet. *Mellon Bank, N.A. v. Metro. Communications, Inc.*, 945 F.2d 635 (3d Cir. 1991), *cert. denied* 112 S. Ct. 1476, 117 L. Ed. 2d 620 (1992). However phrased, this method is a review of the assets and liabilities of the debtor, and a comparison between the two.

When looking at assets, the court must assign to those assets that are readily susceptible to liquidation, *Joshua Slocum, Ltd. v. Boyle (In re Joshua Slocum, Ltd.)*, 103 B.R. 610, 621 (Bankr. E.D. Pa. 1987), their fair market value. *Davis v. Suderor (In re Davis)*, 169 B.R. 285, 299 (E.D.N.Y. 1994); *Pioneer Home Builders, Inc. v. Internaional Bank of Commerce (In re Pioneer Home*

Builders, Inc.), 147 B.R. 889, 892 (Bankr. W.D. Tex. 1992) (fair market value price at time of transfer is most equitable standard). Therefore, assets are best valued by determining what price they would bring on the open market. An open market value has been further defined as that value that a prudent business person could obtain from the sale of an asset when there is a willing buyer and a willing seller. *See Pioneer*, 147 B.R. at 892. Under this approach it is inappropriate to add costs and expenses associated with the sale of the assets. *Id*. The method of market price valuation focuses on what a willing buyer would pay, not necessarily what a willing seller would ultimately receive. *Id*. However, the value can be reduced by factors regarding the difficulty of the sale of the asset, but only if they affect the market price and do not relate to the costs of sale. *Id*. The value may be further adjusted by the net costs of making the asset marketable. *Id*. The court cannot take into consideration the debtor's subjective sentimental value placed upon the item. *Id*. The court can value doubtful or contingent claims at less than face value. *Join-in International Ltd. v. New York Wholesale Dist. Corp. (In re Join-in International (USA) Ltd.)*, 56 B.R. 555, 560 (Bankr. S.D.N.Y. 1986). If a debtor is a guarantor on a liability, courts will generally multiply the total debt by the percent chance that the guarantee will be exercised to determine the liability to be included in the balance sheet. *Covey v. Commercial Nat'l Bank of Peoria*, 960 F.2d 657, 660 (7th Cir. 1992) (cited in 26 Collier Bankr. Cas.2d 1046). Goodwill can be considered an asset, and can be determined by average high earnings over a period of years, valuable customer lists, and/or by trade names. *Standard Supply Co. v. Cohen (In re Roco Corp.)*, 701 F.2d 978, 984 (2d Cir. 1983).

The assets are to be reduced by liabilities. Courts can refer to 11 U.S.C. § 101(4) to determine what is a liability. *See Joshua Slocum, Ltd. v. Byole (In re: Joshua Slocum, Ltd.)*, 103

B.R. 610, 622 (Bankr. E.D. Pa. 1989) (finding that shareholders stock redemptions were not liabilities under Bankruptcy Code § 101(4)).

At least one court has allowed the use of the retrojection method to prove insolvency. *Kanasky v. Randolph (In re R. Purbeck & Assocs., Ltd.),* 27 B.R. 953, 955 (Bankr. D. Conn. 1983) (analyzing insolvency in a preference action). Since insolvency at a given point in time is often difficult to demonstrate by direct proof, courts permit the trustee to show that the debtor was insolvent at one point in time and then prove that the same condition existed at the time of the subject transfer. "This method . . . applies equally to situations in which the trustee starts at a point in time prior to the transfer. . . .[to use this method, the trustee must] show the absence of any substantial or radical changes in the assets or liabilities of the bankruptcy between the retrojection dates." *Id.* Possibly another burden would be to show that the evidence relating to solvency at the time of the transfer was scant. *Id.* (evidence was scant).

6.2.2 Unreasonably small capital remaining

The Bankruptcy Code does not define unreasonably small capital. However, most courts hold that the definition indicates a financial condition short of insolvency. *E.g., Murphy v. Meritor Sav. Bank* (*In Re: O'Day Corp.*), 126 B.R. 370, 407 (Bankr. D. Mass. 1991). However, the condition must be severe enough that it soon turns to, or severely threatens, insolvency; otherwise, the statute is overly broad. *Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.)*, 100 B.R. 127, 137 (Bankr. D. Mass. 1989). Some cases have confused unreasonably small capital remaining with the third subsection, dealing with ability to pay expenses as they become due. *See Pioneer Home Builders, Inc. v. International Bank of Commercie, Inc. (In re Pioneer Home*

Builders, Inc.), 147 B.R. 889, 894 (Bankr. W.D. Tex. 1972). While it is one method of reviewing capital, the method renders this provision meaningless, in light of the next sub-section, § 548(a)(1)(B)(iii), dealing directly with the debtor's ability to pay. However, determining whether enough capital exists to continue the business would not be inappropriate or redundant. *Joshua Slocum, Ltd. v. Boyle (In re Joshua Slocum, Ltd.)*, 103 B.R. 610, 625 (Bankr. E.D. Pa. 1989); *In re Vadnais Lumber Supply, Inc.,* 100 B.R. at 131. *In Vadnais*, the Court held that the analysis must somehow be tied to insolvency. Since the standard is something less than insolvency, then it must somehow be tied to causing or inevitably leading to insolvency. *Id.*. Delving into the courts logic, one is faced with the conclusion that subparts (ii) and (iii) are strikingly similar.

6.2.3. Incurred debt beyond ability to pay

There is scant authority specifically referring to § 548(a)(2)(B)(iii). The language of this provision requires that the debtor intended to incur, or believe he would incur, debts that would be beyond his ability to pay. Bankruptcy Code § 548(a)(2)(B)(iii). Therefore, a fundamental issue is whether this provision applies at all in cases where the transfer is involuntary, especially when the debtor is admittedly solvent. All cases that do discuss the provision examine the intent of the debtor when the transfer was made. The provision requires an affirmative act by the debtor. The court in *Hall v. Quigley (In re Hall)*, 131 B.R. 213, 218 (Bankr. N.D. Fla. 1991), held that involuntary transfers were not contemplated by § 548(a)(2)(B)(iii). *Id.* (reconciling with general "involuntary" language of § 548).

2. Standing to Sue Under Section 548

In examining this issue, one can distinguish defenses to these actions when they are brought prior to the confirmation of a plan of reorganization and post confirmation.

Prior to confirmation, the statute grants the federal fraudulent conveyance cause of action to trustees and debtors-in-possession, and therefore, a creditor generally does not have standing to prosecute an action for fraudulent conveyance. *Gerken v. Harris (In re Auxano, Inc.)*, 87 B.R. 72 (Bankr. W.D. Mo. 1988); *First State Bank of Wykoff v. Grell (In re Grell)*, 83 B.R. 652 (Bankr. W.D. Mo. 1988); *Johston Memorial Hospital v. Hess (In re Hess)*, 21 B.R. 465 (Bankr. W.D. Va. 1982); *see also Thompson v. Myers (In re Myers)*, C/A No. 97-10215-W, Adv. Pro. No. 98-80017-W (Bankr. D. S.C. 7/17/98) (finding that unsecured creditor did not have standing to bring action under Section 548 and stating that the proper party to bring such action was the Chapter 7 trustee). However, courts hold that an individual creditor can bring an action for recovery of an alleged fraudulent transfer provided they can show that the trustee or creditor's committee failed to zealously prosecute the action on behalf of estate. *Canadian Pac. Forest Prod. v. J.D. Irving, ltd. (In re Gibson Group, Inc.)*, 66 F.3d 1436, 1442 (6th Cir. 1995); *In re v. Savings Oil & Heating Co., Inc.*, 91 B.R. 655, 657 (Bankr. E.D.N.Y. 1988); *In re Conley*, 159 B.R. 323, 324 (Bankr. D. Idaho 1993).

In one case, *Glinka v. Abraham and Rose Co, Ltd.*, 199 B.R. 484 (D. Vt. 1996), the court allowed a creditor and the trustee to jointly pursue a fraudulent conveyance action. The court found that by itself, the estate lacked the funds to pursue the claim, and that allowing the creditor to join the trustee imposed no net financial burden on the bankruptcy estate. *Id*. at 493.

So, generally speaking, prior to confirmation, the cause of action belongs to the trustee or debtor-in-possession, but in certain circumstances, other interested parties have been given the opportunity to bring this action.

After confirmation of a plan, the question is whether this cause of action was properly preserved. This defense started in cases that did not deal with avoidance actions. In *Eubanks v. Federal Deposit Insurance Corp.*, 977 F.2d 166 (5th Cir. 1992), the court was examining a post confirmation lender liability claim brought by the reorganized debtor against his secured lender based upon the secured creditors pre-petition actions. The Court held because the secured lender was a creditor under the plan, his claim was determined by the confirmation of the plan and any challenge to this claim could have been brought prior to confirmation. *Id.* at 174. The court went on to hold that the confirmed plan was *res judicata* as to the lender liability action. *Id.* Similarly, in *Browning v. Levy*, 283 F.3d 761, 774 (6th Cir. 2002), the Sixth Circuit held that the plan's "blanket reservation" of causes of action did not preserve a malpractice claim and breach of fiduciary duty claim against a law firm that was also a creditor of the debtor. Both the Fifth and Sixth Circuits seem to hold that Section 1123(b)(3) requires plans to provide for settlement, adjustment or retention of some entity to prosecute the claims belonging to the debtor. This plan requirement, combined with the disclosure statements requirement of "adequate information," seem to require some notice as to what claims are being settled, adjusted or retained. Both the Fifth and Sixth Circuits held that the blanket reservation failed to provide the sufficient notice and therefore, the action was not retained.

Some bankruptcy courts have applied this same logic to preference actions. In the case of *Mickey's Enterprises, Inc. v. Saturday Sales, Inc. (In re Mickey's Enterprises, Inc.)*, 165 B.R. 188

(W.D. Tex. 1994), the court was examining a preference action against a creditor of the estate. The court held that the preference action stemmed from the same nucleus of operative facts as the debtor's proof of claim, the "existing and continuing business relationship." *Id*. at 192. The court went on to hold that *res judicata* applied. As it relates to the same nucleus of operative facts, the superficial treatment of this analysis by this court suggests a lack of understanding of preference litigation. One only has to look at the elements of a preference action and compare them to an action on an invoice or open account to realize these two distinct legal theories do not stem from the same nucleus of operative facts.

Further, most Federal Courts do not even use the general term *res judicata*. Federal Courts examine the preclusive effects of prior determinations in terms of either claims preclusion or issue preclusion. See 18 FEDERAL PRACTICE AND PROCEDURE, § 4402, at 6 (1981) ("the distinctive effects of a judgment [are] separately characterized as 'claim preclusion' and 'issue preclusion'").

Claims preclusion has the "effect of foreclosing any litigation of matters that never have been litigated, because of a determination that they should have been advanced in an earlier suit." *Id*.; *see also Kaspar Wire Works, Inc. v. Leco Engineering & Mach., Inc.*, 575 F.2d 530, 535-36 (5th Cir. 1978). Under claims preclusion, a judgment does not preclude everything that may have been disputed between the parties, it only precludes matters within a certain sphere. 18 FEDERAL PRACTICE AND PROCEDURE, § 4406, at 45 (1981). "Claim preclusion cannot extend beyond the limits of an action that can be brought before a single court." 18 FEDERAL PRACTICE AND PROCEDURE, § 4407 at 51 (1981).

The contemporary approach uses a "transactional definition of a claim or cause of action" to determine the scope of claims preclusion. 18 FEDERAL PRACTICE AND PROCEDURE, § 4407 at 55 (1981); *see also Restatement Second of Judgments*, Section 24 (1981). Basically, a claim extinguished by a first judgment includes:

> all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose. 18 *Federal Practice and Procedure*, § 4407, at 55 (1981); *see also Restatement Second of Judgments*, § 24 (1981).

Thus, the Court must examine the transactions associated with the claim, specifically the elements of the cause of action that would create the claim, and compare those with the elements of the cause of action or claim seeking to be precluded.

Issue Preclusion has the "effect of foreclosing relitigation of matters that have once been litigated and decided." 18 FEDERAL PRACTICE AND PROCEDURE, § 4402, at 6 (1981); *see also Kaspar Wire Works, Inc. v. Leco Engineering & Mach., Inc.*, 575 F.2d 530, 535-36 (5th Cir. 1978). Issue preclusion involves the determination of the following issues:

1. Issue preclusion arises in the second action on the basis of a prior decision when the same "issue" is involved in both actions;

2. The issue was "actually litigated" in the first action, after a full and fair opportunity for litigation;

3. The issue was "actually decided" in the first action, by a disposition that is sufficiently "final," "on the merits," and "valid";

4. It was necessary to decide the issue in disposing of the first action and – in some decisions – the issue occupied a high position in the logical hierarchy of abstract legal rules applied in the first action;

5. The later litigation is between the same parties or involves non-parties that are subject to the binding effect or benefit of the first action;

6. The role of the issue in the second action was foreseeable in the first action, or it occupies a high position in the logical hierarchy of abstract legal rules applied in the second action; and

7. There are no special considerations of fairness, relative judicial authority, changes of law, or the like, that warrant remission of the ordinary rules of preclusion.

18 FEDERAL PRACTICE AND PROCEDURE, § 4416 at 138-39 (1981). Since the argument is that the avoidance action was not disclosed prior to the confirmation of the plan, it can hardly be argued that the preference action was actually litigated.

Thus, neither claims preclusion nor issue preclusion should be a basis upon which a court should hold that an avoidance action is not preserved by a blanket reservation. However, the requirement for adequate information provides a more difficult analysis.

In the recent case of *Elk Horn Coal Co., L.L.C. v. Conveyor Mfg & Supply, Inc. (In re Pen Holdings, Inc.)*, 316 B.R. 495 (Bankr. M.D. Tenn. 2004), the Court was addressing a similar challenge against preference actions. In *Pen Holdings*, the plan defined "avoidance actions" as, among other things, the actions under sections 510, 541, 544, 545, 546, 547, 548, 550 and 553 of the Bankruptcy Code. *Id*. at 497. It then went on to retain the right to prosecute these avoidance actions. *Id.* The Middle Tennessee bankruptcy court found that the adequate information needed to retain actions was for creditors, not for defendants. *Id*. at 504. Therefore, naming specific defendants was not necessary. *Id.* That seems to be a pretty good argument. Adequate information means:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan ...

11 U.S.C. §1125(a)(1). So technically, adequate information is not directed at a creditor, it is directed at a "hypothetical reasonable investor typical of holders of claims." *Id.* Clearly, adequate information is not directed toward defendants in avoidance actions.

The *Pen Holding* court found that avoidance actions are "fundamentally different" than the malpractice and breach of fiduciary duty claims found in *Browning*. 316 B.R. at 504. The court reasoned that they are fundamentally different because (a) they are so numerous that typically debtors do not even complete their preference analysis prior to proposing a plan and to require a debtor to do so is "not practicable," (b) it is a common practice to simply preserve these actions in plans; and (c) nothing in Section 1123 requires that the matters be set out more specifically. *Id.* The court concluded that "preserving the value of preferences for distribution to creditors after confirmation should be easily accomplished in the plan without magic words or typographical traps." 316 B.R. at 505.

While much of the logic in *Pen Holdings* can be applied to fraudulent transfer actions, they are usually not so numerous as to make it "not practicable" for a debtor to complete his analysis. At the same time, while preference actions against non-insiders are limited to a ninety day reach back period, fraudulent transfer actions may reach back one year under current law and two years under

the BAPCPA. Thus, it may be equally as difficult or "not practicable" for a debtor to expend the resources necessary to fully investigate such claims prior to confirmation of a plan.

3. South Carolina Fraudulent Conveyances/Statute of Elizabeth.

South Carolina Code § 27-23-10 et seq, known as the Statute of Elizabeth, states:

> Every feoffment, gift, grant, alienation, bargain, and conveyance of lands, tenements, or hereditaments, goods and chattels, or of any of them, or of any lease, rent, commons, or other profit or charge out of the same, by writing or otherwise, and every bond, suit, judgment, and execution which may be had or made to or for any intent or purpose to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, and forfeitures shall be deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators and assigns, and every of them, whose actions, suits, debts, accounts, damages, penalties and forfeitures by such guileful, covinous or fraudulent devices and practices as is aforesaid, are, shall or might be in any ways disturbed, hindered, delayed, or defrauded) to be clearly and utterly void, frustrate and of no effect, any pretense, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.

S.C. Code Ann. § 27-23-10. This is qualified by § 27-23-40, which states:

> Nothing contained in § 27-23-10 to 27-23-30 shall extend or be construed to impeach, defeat, make void or frustrate any [transfer] made upon or for good consideration and bona fide to any person or body politic or corporate.

"Generally, in causes of action dealing with the Statute of Elizabeth, the burden of proof, by clear and convincing evidence, rests with the Plaintiff. However, 'when considering transfers to family members [. . .] the burden of proof shifts to the transferee to prove both that valuable consideration was exchanged between the parties and the bonafide of the transactions.'" *Anderson v. Simchon (In re South Textile Knitters, Inc.)*, Adv. Pro. No. 99-80026-W (Bankr. D.S.C. 2000); *see also Anderson*

v. Blair (In re Blair), Adv. Pro. No. 99-80410-W (Bankr. D.S.C. 2000) (holding that defendant met the burden of showing that valuable consideration was provided for property transfer); *Campbell v. Haddock (In re Haddock)*, Adv. Pro. No. 99-80266-W (Bankr. D.S.C. 2000) (holding that valuable consideration was not provided when mother transferred property to her daughter for $5.00 with love and affection, while maintaining a life estate herself).

Although the Statute of Elizabeth's protection extends to any and all parties who are defrauded in connection with the conveyance of property, *Mathis v. Burton*, 460 S.E. 2d 406, 408 (S.C. Ct. App. 1995) (citing *Lebovitz v. Mudd*, 358 S.E.2d 698 (S.C. 1987), when a creditor actually becomes a creditor can prove to be important).

South Carolina case law makes a distinction between existing creditors and subsequent creditors. The applicable date of reference is the date of the challenged transfer. A creditor whose claim straddles the transfer date shall be treated according to when the majority of the claim accrued. *Id.*

Creditors who were creditors at the time the transfer took place -- i.e., existing creditors -- can set aside a fraudulent conveyance upon a showing that:

3.1. where the transfer was made for valuable consideration --

3.1.1. the transfer was made by the grantor with actual intent of defrauding his creditors;

3.1.2. the grantor was indebted at the time of the transfer; and

3.1.3. the grantor's intent is imputed to the grantee; or

3.2. where the transfer is made without valuable consideration --

3.2.1. the grantor was indebted to the creditor at the time of the transfer;

3.2.2. the conveyance was voluntary; and

3.2.3. the grantor failed to retain sufficient property to pay the indebtedness to the plaintiff in full, not merely at the time of the transfer, but in the final analysis when the creditor seeks to collect his debt.

Id. [structure of text altered for clarification].

Subsequent creditors, those creditors where at least fifty percent of the claim accrued after the allegedly fraudulent transfer, may set aside a transfer if they show: the conveyance was without consideration and (3.3) it was made with a view to future indebtedness or with actual fraudulent intent on the part of the grantor to defraud creditors.

The obvious difference between existing creditors and subsequent creditors is that an existing creditor can choose between proving lack of consideration and actual fraud whereas a subsequent creditor must always prove lack of consideration and some type of intent. *Id.* at 408-09.

With the exception of the elements requiring a creditor to prove that the debtor was indebted to him at the time of the transfer, 3.1.2 and 3.2.1., all of the aforementioned elements are discussed below in order. As for proof that the grantor was indebted to the creditor at the time of the transfer, this issue has not been fully developed, but it would seem fairly obvious that if one is able to prove that he is an existing creditor -- fifty percent of debt owed prior to transfer -- then these elements are self actualizing, provided a creditor remembers that part of his proof is to show when the debt occurred and the amount.

<u>3.1. Valuable consideration</u>

Obviously, for an existing creditor, the first question that must be answered is whether or not the transfer was for valuable consideration. Valuable consideration means something more than nominal. *Matthews v. Matthews*, 35 S.E. 2d 157, 160 (S.C. 1945). Generally, in South Carolina, a contract need only mention consideration for it to be considered a bonafide exchange for value. However, under fraudulent conveyance law, the standard is higher, and courts will look past the four corners of the document to discern whether the exchange amounted to an arms length transaction. *See First Citizens Bank and Trust Co. of South Carolina v. Scofield*, 286 S.C. 520, 335 S.E. 2d 248, 249 (S.C. Ct. App. 1985) (for $5.00 and "Love and Affection" insufficient language to circumvent Statute of Elizabeth). Valuable consideration is the fair equivalent of the property conveyed. Additionally, any value given must inure to the benefit of the debtor in order to be considered. *Dufresne v. Regency Realty, Inc.of Hilton Head Island*, 366 S.E. 2d 256, 258 (S.C. Ct. App. 1987) (value given to someone other than the debtor does not count as consideration for fraudulent conveyance purposes); *but see Royal 2 Lanes, Inc. v. Collins Holding Corp.*, 524 S.E. 2d 621 (S.C. 1999) (overruling *Dufresne).*

3.1.1. Fraudulent Intent

If valuable consideration was given, the creditor is forced to prove fraudulent intent. In usual circumstances,

> fraudulent intent . . . can be shown only by a consideration of the attendant facts and circumstances, a resort to which must usually be had in order to distinguish between transactions which are bona fide, and those which are not. The Courts frequently must resort to evidence or circumstances which are not properly explained, when such circumstances lead to the belief that a fraudulent intent was present. . . . For fraud is not to be expected to seek the glare of day,

> or the presence of witnesses for its consummation. It is usually effected in secret, and it is only from circumstances [that it may be presumed].
>
> Certain circumstances so frequently attend conveyances to defraud creditors that they are recognized and referred to as "badges of fraud." These badges tend to excite suspicions as to the *bona fides* of a challenged conveyance. Unexplained, they may warrant an inference of fraud. Whether the inference is warranted depends in large measure on whether a satisfactory explanation is presented.
> . . . Among the generally recognized badges of fraud are:
>
> [1] insolvency or indebtedness of the transferor;
> [2] lack of consideration for the conveyance;
> [3] relationship between the transferor and the transferee;
> [4] the pendency or threat of litigation;
> [5] secrecy or concealment;
> [6] departure from the usual method of business;
> [7] the transfer of the debtor's entire estate;
> [8] the reservation of benefit to the transferor;
> [9] retention by the debtor of possession of the property.
>
> Although it has been said that a single badge of fraud may stamp a transaction as fraudulent, it is more generally held that one circumstance recognized as a badge of fraud may not alone prove fraud, where there is a concurrence of several such badges of fraud an inference of fraud may be warranted.

Coleman v. Daniel, 199 S.E.2d 74, 79-80 (S.C. 1973); *Anderson v. Simchon (In re Southern Textile Knitters, Inc.)*, C/A No. 98-07203-W, Adv. Pro. No. 99-80026-W (Bankr. D. S.C. 7/28/00)

3.1.3. Imputing Knowledge of Grantee.

In order to set aside a fraudulent conveyance made where value is given, the creditor must show that the fraudulent intent of the debtor is imputable to the grantee. *Sumner v. Janicare, Inc.*, 294 S.C. 483, 366 S.E. 2d 20, 21 (S.C. Ct. App. 1988). This requires that the transferee have knowledge or participate in the scheme, which can be proven by circumstantial evidence. *SCNB v.*

Halter, 293 S.C. 121, 359 S.E. 2d. 74, 80 (S.C. Ct. App. 1987). Actual knowledge of, or participation in, the debtor's fraudulent intention on the part of the transferee need not be established in order to justify a conclusion that the transaction was fraudulent. The transaction is subject to attack if at the time of the transfer the transferee had notice of circumstances which would arouse the suspicion of any ordinarily prudent man and cause him to make inquiry as to the purpose for which the transfer was being made, which would disclose the fraudulent intent of the maker. *Coleman v. Daniel*, 261 S.C. 198, 199 S.E. 2d 74, 80 (S.C. 1973). Knowledge on the part of a purchaser that the seller is indebted or insolvent has frequently been held sufficient to place a purchaser on notice and to require him to investigate. *Id*. The purchaser need not know of the specific debt that the creditor asserts is being hindered or prejudiced as a result of the transfer. *Id.*

Perhaps the most ambiguous element is the requirement that an existing creditor must prove that a transfer without consideration was voluntary. Under state common law, a voluntary conveyance is a transfer made without consideration or for a mere nominal consideration. *Durham v. Blackard*, 438 S.E. 2d 259, 263 (S.C. Ct. App. 1993). Where nominal or some amount of consideration is paid, the transfer is considered voluntary to the extent the value of the property is more than the consideration paid. *Kirby v. Horne Motor Co.*, 366 S.E. 2d 259 (S.C. Ct. App. 1988).

3.2.2. Conveyance is voluntary

A voluntary conveyance is a transfer made in good faith without consideration or for a mere nominal consideration. *Durham v. Blackard*, 438 S.E. 2d at 263. "A voluntary conveyance which violates the statute [of Elizabeth] will be set aside to the extent of the value of the property transferred less any consideration received in exchange therefore." *Id*.

3.2.3. Insolvency

When an existing creditor is showing that the grantor failed to retain sufficient property to pay the indebtedness to the plaintiff in full, they are in essence attempting to prove insolvency. The court in *Gardner v. Kirven*, 191 S.C. 814, 816 (1937) seems to suggest that the plaintiff needs to show that "[i]f in the final event the property of the debtor is not sufficient to pay his debts existing at the time of this voluntary conveyance, then such conveyance is null and void as to such debts." *Id.* Clearly, the *Garvin* holding suggests that a creditor may show insolvency at the time the debt is sought to be collected. *Garvin* supports the position that in conveying property, debtor's must retain sufficient property to satisfy their debts when they become due. The amount of property that must be retained "means a sufficient amount of property not merely at the time of the transfer, but an amount from which in the final analysis the creditors are able to collect their indebtedness in full." *Id*.

No South Carolina Court has held that this element is presumed or abandoned when the debtor/grantor has filed bankruptcy. Nevertheless, it would seem that a creditor's or trustee's duties in proving this element go beyond simple proof that the debtor filed bankruptcy. The creditor or the trustee must show that the debtor is in fact insolvent. The mere filing of a petition is insufficient because one can file bankruptcy for one of two reasons -- (1) the inability to pay ones debts as they become due, and (2) not having enough assets to pay ones debts. According to *Durham*, a creditor may have to prove that the debtor has insufficient assets to pay the debt, after the transfer. *See Durham*, 438 S.E. 2d at 263 ("McMillan failed to retain sufficient property to pay his debt to Blackard."); *see also Campbell v. Deans (In re J.R. Deans Co., Inc.)*, C/A No. 97-08095-W, Adv.

Pro. No. 99-80231-W (Bankr. D. S.C. 5/21/00) (holding that Plaintiff failed to establish the insolvency of the debtor following the transfer where the debtor's financial records showed that its assets exceeded its liabilities for over one year after the transfer). *See also, Garvin v. Kirven*, 191 S.E. 814 (1937) (the grantor must reserve a sufficient amount of property to pay his creditors). A debtor may have filed for bankruptcy using only the first condition. However, it seems almost tautological to state that if the debtor has enough assets to pay his debts without the necessity of recovering the fraudulent conveyance, the trustee would be hard pressed to justify the suit. Therefore, while the burden to show insolvency is more than showing that a petition was filed, the burden is met once the Trustee establishes that without the recovery of the fraudulent conveyance, the estate will not distribute a 100% payout to creditors.

3.3. Was made with a view to future indebtedness

It appears that the court in *Matthews v. Burton*, 460 S.E.2d 406 (S.C. Ct. App. 1995) and in *Parker Peanut Co. v. Felder*, 20 S.E. 2d 716 (S.C. 1942), was referring to some proof that the debtor knew of the impending indebtedness at the time of the transfer. Although the court in *Gentry v. Lanneau*, 32 S.E. 523 (1899) was even more relaxed and suggested that the creditor need only prove that the transfer was made in anticipation of some future indebtedness.

4. Statute of Limitations

The biggest defense to a Statute of Elizabeth claim is the statute of limitations. Specifically,

> A cause of action based upon *South Carolina Code section 27-23-10* to set aside a fraudulent conveyance must be commenced within six

> years[3] of the conveyance. *S.C. Code Ann. § 15-3-530*. The accrual of the action is tolled, however, until the aggrieved party discovers or should have discovered facts, which by the exercise of due diligence, would be sufficient to put the creditor on notice of the fraud.

Commercial Credit Loans, Inc. v. Riddle, 334 S.C. 176, 185, 512 S.E.2d 123, 128 (Ct. App. 1999). South Carolina courts have long held that a cause of action accrues when the allegedly wrongful conduct occurs. "'A cause of action in deceit accrues immediately on the successful consummation of the fraud.'" *Harold Tyner Development Builders, Inc. v. Firstmark Development Corporation*, 311 S.C. 447, 429 S.E.2d 819, 823 (S.C. Ct. App. 1993), quoting 37 C.J.S. Fraud § 71, at 367 (1943); and citing 37 Am. Jur. 2d Fraud and Deceit § 419, at 568 (1968) ("It is a general principle that where fraud is committed against a person . . . he has an immediate right of action therefor.").

The Plaintiff's cause of action arises when the allegedly fraudulent conveyances took place. The statute of limitations, however, is tolled pursuant to the discovery rule. The discovery rule generally assists the one defrauded, as a claimant cannot bring an action unless he or she has notice of the fraud. The discovery rule determines when the statute of limitations begins to run.

In South Carolina, the discovery rule states that a cause of action to set aside an allegedly fraudulent transfer pursuant to the Statute of Elizabeth accrues, and the statute of limitations begins to run, upon the claimant's "discovery of the fraud itself or of such facts as would have led to the knowledge thereof, if pursued with reasonable diligence.'" *Campbell v. J. R. Deans Co. (In re JR Deans Co., Inc.)*, 249 B.R. 121, 132 (D.S.C. Bankr. 2000); *Burgess v. American Cancer Society*, 300

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[3] In 1988, the Legislature amended the statute by changing six years to three years, which by Act No. 432, became applicable to causes of action arising or accruing on or after April 5, 1988.

S.C. 182, 386 S.E.2d 798, 799 (S.C. Ct. App. 1989)**;** *Grayson v. Fidelity Life Ins.,* 114 S.C. 130, 103 S.E. 477, 478 (1920). "Under this objective test, one is charged with discovery when the facts and circumstances of an injury would put a person of common knowledge and experience on notice that some claim might exist." *Cline v. J. E. Faulkner Homes, Inc.*, 597 S.E.2d 27 (S.C. Ct. App. 2004) citing *Austin v. Conway Hosp., Inc.*, 292 S.C. 334, 339, 356 S.E.2d 153, 156 (S.C. Ct. App. 1987).

The issue is one of notice. Some have argued that there is a bright line test in South Carolina to the effect that the rendering of a nulla bona return is when the plaintiff is first on notice. They base this argument on a limited reading of a 1962 case, *Klein v. Kneece*, 239 S.C. 478, 123 S.E.2d 870 (1962). But this suggestion of a bright line test requiring a *nulla bona* return is incorrect. *Kneece's* requirement to "perfect" the cause of action via a *nulla bona* return was an incorrect reading of that case and later South Carolina cases do not require a nulla bona return to bring such an action.

The *Kneece* Court cited case law from decisions made in the 1800s – *National Bank of Newberry v. Kinard*, 28 S.C. 101, 5 S.E. 464 (1888); *Verner v. Downs*, 13 S.C. 449 (1880); and *Suber v. Chandler*, 18 S.C. 526 (1883)–all of which were later clarified and corrected by rules promulgated in 1930 by *Temple v. Montgomery*, 157 S.C. 85, 153 S.E. 640 (1930). The *Temple* Court recognized the misunderstanding generated by *Suber v. Chandler*, stating:

> The language of Chief Justice Simpson, in *Suber v. Chandler, 18 S.C. 526,* was apparently misunderstood by the members of the bar, and perhaps by some of our very able Judges. In that case, the distinguished jurist, not discussing the necessity of showing a *nulla bona* return, but considering the question of when the plaintiff's right of action accrued, in the course of his remarks, said this:

> "Hence, it has been often held that a creditor, before attempting to assail the conveyance of his debtor, must not simply be apparently unable to secure payment otherwise, but must absolutely fail to do so after exhausting all legal effort to that end, by judicially establishing his debt *and having a return of nulla bona by the sheriff upon an execution issued thereon.*" (Emphasis added.)

> On account of the statement made by Chief Justice Simpson, it seems that some of the lawyers and Judges thought, *in all cases* to set aside a deed by an alleged insolvent person, it was necessary not only to prove, but to allege, the return of a *nulla bona* on the execution.

Temple, at 644 (emphasis in original). After examining many cases at length, including *Kinard*, *Verner* and *Suber*, the *Temple* court set up four rules regarding the *nulla bona* requirement:

> Summarizing briefly the holdings in the cases reviewed, and where there is conflict, seeking to clear it up, we conclude:
>
> (1) The law requires in an action by a creditor *solely* to set aside his debtor's *voluntary deed, for legal fraud,* allegation and proof that the debt was reduced to judgment, execution issued to enforce the collection of the judgment, and a *nulla bona* return on the execution by the sheriff.
>
> (2) In an action by a creditor, to set aside his debtor's deed, based on *actual or positive fraud,* it is not necessary to allege or prove a *nulla bona* return, nor even to reduce the debt to judgment.
>
> (3) To institute or maintain a creditor's suit to marshal the assets of his deceased debtor, or in an action to sell realty in aid of personalty to pay debts, it is not required that there be any *nulla bona* return, or execution, or judgment.
>
> (4) The *nulla bona* return in any of the cases mentioned above is *some evidence* of insolvency of the debtor, and the impossibility of the creditor to collect his debt *at law;* and,

> when nothing else appears to the contrary, this evidence is *conclusive* as to those matters.

Id. at 646 (emphasis in original). *Temple, Suber* and *Kinard* required a nulla bona return because the action was based on allegations of "legal fraud," which today is known as "constructive fraud." In constructive fraud, the intent to defraud is not part of the claim and the action is solely to set aside the voluntary transfer. According to the *Temple* rules, an action for *actual* or positive fraud does not require a *nulla bona* return or even that the claimant reduce the debt to judgment prior to bringing an action.

The *Kneece* Court confused the issue quoting *Suber* and *Kinard*, and misapplied the *Temple* rules, as the plaintiff in *Kneece* brought a claim for actual fraud, for which a *nulla bona* is not required. In *Temple*, the court held that a *nulla bona* return was not required in that case because:

> **[t]he action was not for the sole purpose of setting aside the deed**. The demand that the deed be declared null and void, and the allegations upon which that demand was based, were merely incidental to **the main purpose of the action, namely, to marshal the assets of the decedent and to subject them to the payment of the debts** of her estate.

Temple at 643 (emphases in bold added). In the *Kneece* case, as in the current case, the claimant alleged actual or positive fraud and the main purpose of the action was to marshal assets to pay a debt, which according to the *Temple* rules *does not require* a *nulla bona* return.

Despite the erroneous application of the *Temple* rules, the *Kneece* Court clearly understood the notice requirement necessary for this type of action. *Kneece* clearly recognized the law regarding the accrual of a cause of action, and provided cites, such as:

(1) "an action to set aside a conveyance of lands made contrary to [the Statute of Elizabeth] must be instituted within six years and the cause of action in such case in not deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud"

Kneece, at 873, citing the then-current Statute of Limitations, Section 10-143(7) of the 1952 Code;

(2) "the six year period begins to run at the time of the acquisition of knowledge of such facts that are sufficient to put the party on inquiry, which if developed, will disclose the alleged fraud."

Id. at 874, citing *Tucker v. Weathersbee*, 98 S.C. 402, 82 S.E. 638 (1914);

(3) "A cause of action accrues, so as to start the running of the statute of limitations, as soon as the right to institute and maintain the action arises."

Kneece, at 874, citing *Tuten v. Almeda Farms*, 184 S.C. 195, 192 S.E. 153 (1937); *Wooten v. Standard Life & Casualty Insurance Co.*, 239 S.C. 243, 122 S.E.2d 637 (1961);

(4) "The law requires in an action by a creditor ***solely*** to set aside his debtor's voluntary deed, ***for legal fraud***, allegation and proof that the debt was reduced to judgment, execution issued to enforce collection of the judgment, and a *nulla bona* return on the execution by the sheriff."

Kneece at 874, citing *Temple v. Montgomery*, 157 S.C. 85, 153 S.E. 640 (1930) (emphasis added);

(5) "A proceeding to set aside a deed upon the ground of fraud . . . must be commenced within six years from the time when the facts constituting the fraud are discovered by the aggrieved party."

Kneece at 874, citing *Kibler v. McIlwain*, 16 SC 550 (1882);

(6) "'But there were facts and circumstances existing and which were known to the creditors, or could have been known to them by the exercise of ordinary care and diligence, which if they had been followed up would have developed the facts in the case, and, that being the case, they are barred from bringing the action.'"

Kneece at 875, quoting *Tucker v. Weathersbee*, *supra*; and citing *Brown v. Brown*, 44 S.C. 378, 22 S.E. 412 (1895); *Wood v. Carpenter*, 101 U.S. 135, 25 L.Ed. 807 (1879); and

> (7) "The notice will be sufficient to prevent the suspension of the statute, if it be such, as would put a reasonably diligent man upon inquiry. Nor must the aggrieved party wait until he has discovered evidence by which he may establish the fraud in a court of justice. If he has knowledge that a fraud has been committed, though that knowledge be confined to himself, he must proceed diligently; for the statue in such case will not be suspended."

Kneece at 875, citing *McLure v. Ashby*, 28 S.C. Eq. 430.

The "bright line" *nulla bona* test as described in *Kneece* does not specify the *earliest* date on which a creditor is attributed with notice, but the *latest* time, as the *nulla bona* return provides incontrovertible notice sufficient to put the creditor on inquiry. The claimant may be put on notice by other circumstances or means. See *Commercial Credit Loans, Inc. v. Riddle*, 334 S.C. 176, 185, 512 S.E.2d 123, 128 (S.C. Ct. App. 1999) ("we decline to give the *nulla bona* return the same significance the Kneece court attached to it. Thus, it was not until October 25, 1996, when the agreement between Riddle and Kyzer was recorded, that Commercial Credit could be charged with facts sufficient to put it on notice of fraud"); *Anderson Hardware Co. v. Gray*., 94 S.C. 80, 84, 77 S.E. 742, 743 (1913), ("it was not necessary for the plaintiffs, to prove a *nulla bona* return on the execution, in order to establish the fact of insolvency, ***which could be shown, by any other competent testimony.***")(emphasis added).

In *Kneece*, the claimant's cause of action accrued at that point, as that was when the claimant received notice that the defendant did not have assets with which to satisfy the debt. The *Kneece* court reversed the lower court, and held that the action in that case should have been barred by the

statute of limitations because the action was commenced "more than six years from the time the respondent knew or had sufficient information to put it on inquiry as to the facts which it now asserts to be fraud," not more than six years after the *nulla bona* return. *Kneece*, 239 S.C. at 87, 123 S.E.2d at 876 (S.C. 1962).

The *Kneece* Court stated that *in that case*, the *nulla bona* return "was notice that Jack M. Kneece had no property which could be subjected to the satisfaction of said judgment," and that it "put the respondent on notice." *Kneece* at 874. The Court stated that when the *nulla bona* return was made "the respondent was placed in the possession of information, by which, with proper diligence it might have come to the knowledge of the facts." *Id.*

The Court explained that "[s]ince it appears that the respondent knew, at the time of extension of credit to Jack M. Kneece, that he owned certain real estate and such was a factor in the extension of credit to him, it is apparent to us that the *nulla bona* return made by the sheriff put the respondent on notice that Jack M. Kneece had no property which could be subjected to the collection of the judgment by execution." *Id.* The Court held that the statute of limitations had run as the claimant had notice, by way of the *nulla bona* return, in 1950, but failed to begin an action until 1960. *Id.* Again, the issue is one of *notice*. A creditor may acquire such notice prior to a *nulla bona*, and it is *that notice* that begins the statute of limitations.

After *Kneece*, the South Carolina Court of Appeals in *Commercial Credit Loans, Inc. v. Riddle*, stated:

> [W]e decline to give the *nulla bona* return the same significance the Kneece court attached to it. Thus, it was not until October 25, 1996, when the agreement between Riddle and Kyzer was recorded, that

> Commercial Credit ***could be charged with facts sufficient to put it on notice of fraud***.

Riddle, 334 S.C. 176, 185, 512 S.E.2d 123, 128 (S.C. Ct. App. 1999) (emphasis added). *See also Burgess v. American Cancer Soc.*, 300 S.C. 182, 386 S.E.2d 798, 799 (S.C. Ct. App. 1989) (the inquiry must be focused upon whether the complaining party acquired knowledge of any existing facts "sufficient to put said party on inquiry which, if developed, will disclose the alleged fraud").

A plaintiff must reasonably and diligently pursue the facts in order to timely assert a claim. The South Carolina Supreme Court explained "reasonable diligence" as follows:

> The exercise of reasonable diligence means simply that an injured party must act with some promptness where the facts and circumstances of an injury would put a person of common knowledge and experience on notice that some right of his has been invaded or that some claim against another party might exist. The statute of limitations begins to run from this point and not when advice of counsel is sought or a full blown theory of recovery developed.

Berry v. McLeod, 328 S.C. 435, 492 S.E.2d 794, 799 (S.C. Ct. App. 1997), citing *Mitchell v. Holler*, 311 S.C. 406, 429 S.E.2d 793 (1993). See also *Rumpf v. Massachusetts Mutual Life Insurance Co.*, 357 S.C. 386, 395, 593 S.E.2d 183, 187 (S.C. Ct. App. 2004):

> We have interpreted the "exercise of reasonable diligence" to mean that the injured party must act with some promptness where the facts and circumstances of an injury place a reasonable person of common knowledge and experience on notice that a claim against another party might exist. Moreover, the fact that the injured party may not comprehend the full extent of the damage is immaterial.

See also *Burgess v. American Cancer Soc., South Carolina Div., Inc.*, 300 S.C. 182, 185, 386 S.E.2d 798, 800 (1989) ("A party cannot escape the application of this rule by claiming ignorance of existing facts and circumstances, because the law also provides that if such facts and circumstances

could have been known to the party through the exercise of ordinary care and reasonable diligence, the same result follows.")(emphasis in original); *Commercial Credit Loans, Inc. v. Riddle*, 334 S.C. 176, 183-84, 512 S.E.2d 123, 127 (S.C. Ct. App. 1999) ("The accrual of the action is tolled, however, until the aggrieved party discovers or should have discovered facts, which by the exercise of due diligence, would be sufficient to put the creditor on notice of the fraud."); *Tucker v. Weathersbee*, 98 S.C. 402, 413, 82 S.E. 638, 639 (1914) ("An action in equity is barred within six years if the creditors had knowledge of facts sufficient to put them on inquiry, which would have developed the facts which they call a fraud. Or in other words, knowledge of such facts as would have led to the knowledge if pursued with reasonable diligence.").

The test for determining the facts and circumstances that would have put a person of common knowledge and experience on notice that some right had been invaded or a claim against another party might exist has been found by the South Carolina courts to be an objective determination, not a subjective one. *See Maher v. Tietex Corp*. 331 S.C. 371, 500 S.E.2d 204, 206 (S.C. Ct. App. 1998). A plaintiff will lose the right to press a claim if the facts have not been investigated or pursued with reasonable care and diligence to bring suit within the statute of limitations, as pointed out by the South Carolina Supreme Court in *Tucker v. Weathersbee*:

> Even if the facts developed and contended for as fraud constituted a fraud sufficient to set aside the deed or deeds in question, I find as a matter of fact from the testimony and the facts and circumstances surrounding the transaction in question, that the plaintiffs and their agents ***had knowledge of such facts as would have led to the discovery of the facts proven if pursued with reasonable care and diligence*** more than six years before the commencement of this action, and consequently the action comes within the prohibition of the statute and cannot be sustained.

98 S.C. 402, 413, 82 S.E. 638, 639 (1914) (emphasis added). The *Tucker* Court dismissed the plaintiff's claims, ruling that the statute of limitations had run, reasoning that the plaintiff had sufficient notice, stating:

> [T]here were facts and circumstances existing, and which were known to the creditors, or could have been known to them by the exercise of ordinary care and diligence, which, if they had been followed up would have developed the facts in the case, and that being the case, they are barred from bringing the action.

Id., citing *Brown v. Brown*, 44 S.C. 378, 22 S.E. 412 (1895). See also *Poco-Grande Invest. Inc. v. C&S Family Credit*, 301 S.C. 323, 391 S.E.2d 735, 736 (1990) ("A party must avail himself of the knowledge or means of knowledge open to him. The court will not protect the person who, with full opportunity to do so, will not protect himself."); *Burgess v. American Cancer Soc., South Carolina Div., Inc.*, 300 S.C. 182, 185, 386 S.E.2d 798, 800 (1989) ("a claim for fraud is barred if not filed by the proper party within six years of the time from which pertinent facts were actually known *or could have been known through the exercise of reasonable diligence*.")(emphasis in original).

Therefore, the Plaintiff's right to bring a claim to set aside an allegedly fraudulent transfer accrued and the statute of limitations begins to run when the fraudulent conveyance takes place, however, the statute is tolled by the discovery rule until the Plaintiff acquired knowledge of the alleged fraud itself or acquired such facts as would have led to the knowledge thereof, if pursued with reasonable diligence. Further, the statute can be tolled no further than the return of a *nulla bona* which gives the plaintiff sufficient notice to engage in the reasonable diligence necessary to determine if a fraudulent conveyance has occurred.

5. Conclusion

Prosecuting and defending fraudulent conveyances can be a complex and difficult area. In bankruptcy, the actions can be brought under either bankruptcy law, Section 548, or using South Carolina statutory law referred to as the Statute of Elizabeth. While the elements under the bankruptcy code and South Carolina law are similar and in some instances almost identical, there are subtle differences.