Comment, WHEN A "GIFT" IS MORE THAN JUST A GIFT: THE UNIFORM FRAUDULENT TRANSFER ACT APPLIED AT DIVORCE

The recent high-profile divorce of multimillionaire and L.A. Dodgers owner Frank McCourt and his wife Jamie encompasses all the soap opera elements of gossip and intrigue: infidelity, buckets of money, and, quite possibly, fraud.[1] McCourt contends that his ex-wife signed their post nuptial agreement to purposefully shield their seven luxury homes from creditors, while Ms. McCourt maintains her wide-eyed innocence, insisting that she was not aware of the terms of the contract at the time of signing.[2] Although the mind-boggling wealth and assets accumulated by the McCourts is beyond the reach of the average party to a divorce, the unfolding drama presents a not-uncommon scenario: when one spouse engages in "asset protection," that actually functions as a fraudulent transfer to put debts out of the reach of creditors, or to keep the asset out of consideration for determination of spousal or child support.

When financial decisions cross the line from preventative planning into the land of fraud, the Uniform Fraudulent Transfer Act (UFTA, or "the Act") is one tool that may be invoked in many states to provide relief to creditors.[3] Although the UFTA is often relied upon in the business or commercial context to regulate transfers in business partnerships or leveraged buyouts, the Act has unique applications in the context of divorce: for instance, the legal structures made available by the UFTA are sometimes at odds with public policy related to family law. Additionally, like other types of "uniform" legislation, the title is misleading because the UFTA is not applied uniformly across all jurisdictions that have adopted it. This is the case because certain terms are not clearly defined within the statutory language; the legislatures of states that adopt the Act may change portions of

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1 Robert Frank, *How to Shield Assets Like the Rich*, WALL ST. J. (August 31, 2010, 12:09PM), http://blogs.wsj.com/wealth/2010/08/31/how-to-shield-assets-like-the-rich/.

2 *Id*.

3 UNIF. FRAUDULENT TRANSFER ACT, 7A U.L.A. 129 (2006).

the language as they see fit; and courts may choose to apply different standards or tests when considering factors related to the transfer.

This Comment first provides a brief overview of the history and evolution of fraudulent transfer law; then examines the current state of the law regarding the Uniform Fraudulent Transfer Act, through varying jurisdictional approaches to application of the Act when parties divorce; and finally, suggests that due to the unique challenges surrounding divorce, a circumstantial evidence standard should be applied, as this standard allows the court more flexibility in order to reach the most equitible result for the parties.

I. History of the Act

The Uniform Fraudulent Transfer Act as it exists today had origins in sixteenth century English common law penalizing fraudulent conveyance, or "infringement of the creditor's right to realize upon the available assets of his debtor."[4] The Statute of Elizabeth of 1518 is still present in the common or statutory law of every American jurisdiction.[5] Five states still retain the 1918 Uniform Fraudulent Conveyance Act (UFCA), which codifies the Statute of Elizabeth, but expands it to cover both constructive and actual fraudulent transfers.[6] Generally, there is no difference between application of fraudulent transfer law under the Statute of Elizabeth and the UFCA, because states that have not adopted the UFCA have other similar rules and presumptions for determining intent.[7]

In 1984, the National Conference of Commissioners on Uniform State Laws approved a replacement for the UFCA, the Uniform Fraudulent Transfer Act (UFTA).[8] Currently, forty-four jurisdictions and the District of Columbia have adopted the UFTA.[9] The UFTA is heavily influenced by, and even mirrors in

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4 Michael L. Cook, et al., *Fraudulent Transfers*, 929 PLI/Comm 531, 537 (Nov. 2010).

5 *Id*. at 542.

6 *Id.*

7 *Id.*

8 *Id.* at 543.

9 *Id.*

some cases, the Bankruptcy Code.[10] The current version of the Act reflects the original purpose of the law: to protect creditors from transfers made by a debtor that operate solely to prevent creditors from collecting the debt.[11]

Changing the title from Uniform Fraudulent Conveyance Act was important to better communicate that the statute applied to transfers of personal property, as well as real property.[12] Additionally, the UFTA added provisions such as rendering transfers to insiders[13] voidable, and providing a statute of limitations.[14] Some courts have held that the statute of limitations does not begin to run until a creditor obtains a judgment on the debt.[15] However, the language of the Act only outlines that claims may be brought "after the transfer was made or the obligation was incurred."[16]

The language of the current statute defines "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 a lien or other encumbrance."[17] A transfer is fraudulent when it is made with the intent to "hinder, delay or defraud present or future creditors."[18] The intent of the transferee can be actual or constructive,[19] and courts require different types of evidentiary proof to establish each type of fraud.

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10 *Id.* at 544.

11 Amanda Barkey, *The Application of Constructive Fraud to Property Divorce Settlements: What's Fraud Got To Do With It?* 52 WAYNE L. REV. 221 (2006).

12 8 Witkin Cal Pric. Enf. Judgm. § 488

13 *See* Comment to UFTA § 1(7) ("[The word "includes" is not limiting, however. Thus, a court may find a person living with an individual for an extended time in the same household or as a permanent companion to have the kind of close relationship intended to be covered by the term "insider." Likewise, a trust may be grounds to be an insider of a beneficiary.").

14 UNIF. FRAUDULENT TRANSFER ACT § 9 (1984).

15 Cortez v. Vogt, 52 Cal.App.4th 929 (1997).

16 UNIF. FRAUDULENT TRANSFER ACT § 9 (1984).

17 UNIF. FRAUDULENT TRANSFER ACT § 1 (12) (1984).

18 UNIF. FRAUDULENT TRANSFER ACT § 5(a)(1) (1984).

19 Barkey, *supra* note 11, at 223.

A. *Actual Fraud*

Establishing actual fraud requires proof of "actual intent," or "fraud in fact."[20] In times when proving transferor's intent is difficult, courts allow an inference of fraud by examining whether there is the existence of "badges of fraud."[21] These badges may include: actual litigation was brought against the transferor; litigation was threatened against the transferor; substantially all the property owned by the transferor was indeed transferred; the existence of a special relationship between the transferor and the transferee; and whether or not the transfer was concealed.[22]

Further, without "significantly clear" evidence of a legitimate purpose, the presence of multiple badges can create a presumption of actual intent to defraud.[23] Jurisdictions differ as to what constitutes evidence of fraud; for example, not all jurisdictions find that a parties' relationship alone constitutes a badge of fraud.[24]

B. *Constructive Fraud*

The elements of constructive fraud are found in the statute, and the statute provides: 1) a transfer was made or an obligation was incurred by the debtor; 2) for less than reasonably equivalent value; 3) and the debtor was insolvent at the time of transfer, or was made insolvent by the transfer.[25] Courts do not always consider claims based on constructive fraud as favorably as they do claims for actual fraud.[26] Though constructive fraud is established using an objective standard, it can be easier to prove than actual fraud; however, it can also be complicated territory since

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20 Barkey, *supra* note 11, at 224.

21 UNIF. FRAUDULENT TRANSFER ACT § 4(b)(1) (1984).

22 Peter R. Brown & George L. Cushing, *Understanding "Estate Planning": Asset Protection or Fraudulent Conveyance*, 16 J. AM. ACAD. MATRIM. LAW. 347, 369-70 (2000); *See also* Max Sugarman Funeral Home, Inc. v. A.D.B. Investors, 926 F.2d 1248 (1st Cir. 1991).

23 *Max Sugarman Funeral Home*, 926 F.2d at 1254-55.

24 Kenneth W. Biedzynksi and Stephanie Giggetts, Fraudulent Conveyances and Transfers, 37 Am. Jur 2d § 32 (2012).

25 *See* 11 U.S.C. § 548(a).

26 Andrea Carroll, *Incentivizing Divorce*, 30 CARDOZO L. REV. 1925, 1942 (2009).

there may be no concrete manner in which to prove lack of reasonably equivalent value.[27]

1. *Determinations of Reasonably Equivalent Value*

An example of a court making a determination of reasonably equivalent value is found in *Mejia v. Reed*.[28] Reed had an extramarital relationship with the plaintiff, which resulted in the birth of a child.[29] Reed's wife filed for divorce, and the couple entered into a settlement agreement determining that the husband would transfer all of his interest in their joint estate to the wife.[30] The wife transferred all of her interest in the husband's medical practice to him, and a judgment was entered.[31]

Soon after, Reed closed his practice and Mejia filed suit, attacking the settlement agreement between Reed and his ex-wife as a fraudulent transfer under UFTA. The plaintiff argued that the transfers were fraudulent because at the time the Reeds entered into the matrimonial settlement agreement, "the discounted present value of the husband's future child support payments was greater than the value of assets distributed to him."[32] Reed moved for summary judgment, arguing that Mejia presented no evidence of his intent to defraud.

The Supreme Court of California noted that although uniform transfer law covers debts, child support payments are unique and not to be considered debts under the statute, because most people "do not have sufficient assets at the time they are charged with child support payments to pay out the present value of the total amount of payments due."[33]

2. *Issue Preclusion*

In addition to difficult determinations of reasonably equivalent value, the courts of some jurisdictions have considered issue preclusion to be an obstacle in the divorce context,

27 *Id*.
28 74 P.3d 166 (Cal.2003).
29 *Id.* at 168.
30 *Id.*
31 *Id.*
32 *Id.*
33 *Id,* at 175.

when determining whether a transfer is fraudulent.[34] The problem these courts have identified is that the "central issue in a fraudulent transfer case—the equity of the transfer—is one on which a divorce court has already ruled."[35] Other courts have held that a court reviewing a divorce settlement for purposes of determining whether it violates the UFTA can avoid facing issue preclusion by making a "surface determination" that the parties' settlement was within the range that would have resulted from litigating the issue.[36]

Overall, constructive fraudulent transfer decisions in the divorce context are divided and inconsistent. The constructive fraud rules "cannot be relied upon to set aside a large number of transfers made pursuant to divorce settlements."[37]

II. The UFTA in the Matrimonial Context

In proving actual or constructive fraud within the text of the UFTA, there exist varying avenues through which a divorcing or divorced party may invoke the statute and seek relief. First, parties may attempt to prove that they (or their ex-spouses) have obtained debtor-creditor status.

A. *Debtor-Creditor Status*

The term "debtor" is defined within section 1 of the UFTA as "a person who is liable on a claim."[38] Under the Act a claim means "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured."[39]

Although states that have adopted the Act refer to the statutory language when determining who qualifies as a debtor, jurisdictions may draw the line differently depending on whether they utilize a strict or more fluid reading of the statute. In *Folmar v. Holberg*, the Supreme Court of Alabama determined that an ex-

34 Barkey, *supra* note 11, at 223.
35 *Id.*
36 *Id.*
37 *Id.*
38 Unif. Fraudulent Transfer Act § 1 (5) (1984).
39 *Id.* at § 3.

wife could not bring a claim of fraudulent transfer against her ex-husband's second wife, business partner, and financial advisor.[40] The plaintiff argued that fraudulent transfer statutes in the jurisdiction were to be liberally construed. The court ultimately held, however, that the claim could not be brought under the UFTA: even applying a liberal construction of the Uniform statute, the husband was not a "debtor" because the offending transfer was not made by him.[41]

In *Estes v. Titus*, the Michigan Supreme Court outlined two rules of UFTA application and status. First, the court held that property owned by spouses as tenants by the entirety and later dissolved in a divorce judgment could not be reached under a UFTA action unless *both* spouses were debtors on the claim that was subject to the action.[42] Second, while the court established that some property was exempt from the creditors of only one spouse, the *Estes* opinion also explained that third parties can be joined in a divorce action—but only if a conspiracy existed with one spouse to defraud the other spouse of property interest.[43]

"Creditor" is defined within the statute language as "a person who has a claim."[44] Due to ambiguity in the statute's definition of creditor, some jurisdictions have opted for a stretching and expanding of the term, to allow not only banks and traditional lenders, but also ex-spouses to bring claims under the umbrella of UFTA. In *Rich v. Rich*, a first wife filed suit against her former husband under the UFTA, asserting that the husband had actual intent to defraud her by transferring property to his second wife soon after he was found to be in arrears for child support payments.[45] The court determined that an "interspousal transfer of property is clearly subject to the Uniform Fraudulent Transfers Act," and ordered a remand with the court applying the UFTA, since the first wife was considered to be a "creditor"

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40 Folmar v. Holberg, 776 So. .2d 112 (Ala. 2000).

41 *Id.*

42 Estes v. Titus, 751 N.W.2d 493 (Mich. 2008).

43 *Id*.

44 UNIF. FRAUDULENT TRANSFER ACT § 1 (4) (1984).

45 405 S.E.2d 858 (W. Va. 1991). *See also* Caldwell v. Caldwell, 92 N.W.2d 356 (Wis. 1958) (holding that the ex-wife was a creditor where the husband transferred securities to his son to avoid paying adequate alimony and child support).

of her husband.[46] The court also found the first wife to be an "insider" under the Act, since the definition includes the word "relative."[47]

The Supreme Court of Nebraska came to the opposite conclusion in 2008. In *Reed v. Reed*, the court established that a spousal right to equitable distribution of the marital estate did not qualify as a "right to payment" under the UFTA. The court instead applied a nexus standard and said that there must be a correlation between "the claim upon which an individual's creditor status depends, and the purpose for which an individual seeks to set aside a fraudulent transfer."[48] Without a legitimate right to payment, the court reasoned, the wife did not qualify for creditor status to bring her UFTA claim.

Massachusetts has articulated an imminency standard to prove debtor-creditor status after a divorce, stating that where divorce proceedings are "imminent," a spouse may qualify as a creditor and may "complain of conveyances designed to frustrate the right to alimony or assignment of property."[49] However, marriage by itself does not automatically afford a spouse creditor status, and divorce proceedings do not subject all transfers made during marriage to examination under the statute.[50]

1. *Subsequent Creditor Test*

Timing is also an issue in jurisdictions considering the UFTA using a subsequent creditor test. This standard that considers *when* the claim arose in relation to the transfer, instead of considering the timing of the transfer in relation to the event of divorce. This would apply to facts in which a spouse made a transfer (sometimes as a "gift") that caused him to become insolvent, and the claim arose afterward. In addition to the timing of a transfer, a court will consider whether the transfer had reasonably equivalent value, and then the insolvency of the debtor. The insolvency issue could be determined using a balance sheet equation, of the debtor's total assets less total liabilities.

46 *Rich*, 405 S.E.2d at 858.

47 *Id.*

48 Reed v. Reed, 747 N.W.2d 22 (Neb. 2008).

49 Dumont v. Godbey, 415 N.E.2d 190 (1981). *See also* Jorden v. Ball, 357 Mass. 468, 472 (1970).

50 *See* Barkey, *supra* note 11.

2. *Existing Creditor Test*

If the creditor brought a claim, and then the debtor was insolvent and transferred property to an insider, the transfer is likely considered fraudulent.[51] Even if a debtor had no knowledge of the claim at the time of transfer, courts applying the existing creditor test will use a presumption that the transfer was made to avoid paying the creditor. It is significant that this test only applies to transfers to insiders; if a transfer is to someone other than an insider, the elements are not met and the test fails. In the context of family law, practitioners should consider who may qualify as an insider: while courts will consider a transfer among business associates, there seem to be particular red flags around transfers among members of a family; and persons related by blood, or marriage.[52] The individuals in these relationships are likely to be considered insiders.

This evaluation also determines that an insider must know or have reason to know that the debtor was insolvent at the time of the transfer,[53] though there exists no affirmative duty on the part of the insider to investigate.

B. *Circumstantial Evidence Test*

The tests under debtor-creditor status are "bright-line," in that each standard maintains elements that must be met. If the court determines that the elements are not sufficiently met, the claim may not be brought under UFTA. However, this type of mechanical rule is inappropriate for implementation in the realm of divorce and family law. As a matter of public policy, due to the unique emotional and relational as well as economic challenges of the divorce context, a circumstantial evidence standard should be applied. This standard looks to many aspects or "badges of fraud" to establish actual fraud, and allows the court to take into consideration more factors than a black-or-white, bright-line examination. Because divorce decrees themselves are determined based on a subjective,[54] not objective, standard, it

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51 UFTA § 5(b) (1984).

52 Biedzynksi, *supra* note 24 at 32.

53 Martino v. First Bank of Beverly Hills, Cal. Rptr.2d, 2002 WL 358824 (2002).

54 Barkley, *supra* note 11, at 223.

follows that an action to set aside a divorce judgment on UFTA grounds should also be based on a subjective examination of numerous factors.

It is important to distinguish, however, an attempt to establish actual fraud using circumstantial evidence from one to establish constructive fraud. Law professor Amanda Barkey has articulated that applying constructive fraud law to divorce property settlements is undesirable because it causes "undue hardship to non-debtor spouses, infringes on state court authority, and unravels painstakingly negotiated property settlements."[55]

III. Remedies Under the UFTA

Remedies under the UFTA are limited to some extent, since the Act has traditionally determined only the creditor's right to fraudulently transferred property.[56] However, the language of the Act may also be read to suggest that it operates to actually expand a creditor's remedies.[57] In fact, where UFTA conflicts with law that may give a result favorable to a debtor, often the UFTA will supersede the other law in favor of the creditor.[58]

Once a creditor has obtained judgment on the underlying claim, the court may order execution upon the transferred assets or the proceeds of the transfer.[59] This remedy is not available to creditors that have not yet obtained a judgment. The court may give relief to both creditors who hold judgments and also claimants whose claims have not yet been rendered judgment,[60] the court may choose to void the transaction to the measure necessary to satisfy the claim of the creditor.[61]

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55 *Id.*

56 Honor S. Heath, *Fraudulent Transfers*, 1-8 BUS. TORTS § 8.07 (2010).

57 The Uniform Fraudulent Transfer Act section 10 provides: "Unless displaced by the provisions of this [Act], the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement its provisions."

58 *Id.*

59 UNIF. FRAUDULENT TRANSFER ACT § 7(b) (1984).

60 *See* UNIF. FRAUDULENT TRANSFER ACT § 6 comment.

61 UNIF. FRAUDULENT TRANSFER ACT § 7(a)(1) (1984).

If the court does choose to grant that relief, the creditor may recover judgment for the adjusted[62] value of the asset transferred, "against the transferee or any other later transferee who took for value from the transferee, except for a good-faith transferee."[63] The court may also choose to attach the assets;[64] enjoin the assets from further transfer;[65] provide the appointment of a receiver to take control of the assets;[66] or order "any other relief the circumstances may require."[67]

IV. Conclusion

Though the UFTA is called a "uniform" law, application of the statute in jurisdictions that have adopted it are anything but. In determining first, whether a transfer was fraudulent and second, whether a claim may be brought under UFTA, jurisdictions may come to varying conclusions based on the state versions of the statute or the choice of the court to apply a debtor-creditor, subsequent creditor, existing creditor, or circumstantial evidence standard. Because the circumstantial evidence standard uses a subjective lens and tends to consider the broadest range of "badges of fraud," it is most appropriate to apply in the context of divorce, to reach the most fair and just result for the parties.

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62 *Id.,* § 8(b).
63 *Id.*
64 *Id*. § 7(a)(2).
65 *Id*. § 7(a)(3)(i).
66 *Id*. § 7(a)(3)(ii).
67 *Id*. § 7(a)(3)(iii).