

Perspective



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This newsletter is designed to address legal issues that impact lending in Florida. Whether making loans or collecting bad loans, *The Lender's Perspective* will provide timely and valuable insight to the creditor.

Fraudulent Transfer of Assets

By Douglas L. Waldorf, Jr., J.D., M.B.A.

Lenders are frequently faced with collecting a judgment from a debtor who claims to have no assets.

Of course they looked great as potential borrowers when they submitted their personal financial statements in connection with the loan application. But now, with the loan defaulted and reduced to judgment, their assets have mysteriously disappeared or have been substantially reduced. This gives rise to the question: What happened to the assets and have there been any fraudulent transfers? This, in turn, raises a number of additional questions which are the subject of this edition of *The Lender's Perspective*.

What is a transfer of assets?

A "transfer" can involve one or multiple assets and can take several forms. The most common perhaps is an outright sale of an asset. Gifts are another form of transfer. It is interesting that incurring a debt obligation can also be a transfer. Consider, for example, a debtor who owns an asset, such as a parcel of real property, that is unencumbered or otherwise has equity. If that debtor incurred a debt secured by a mortgage on that property, the transaction may be considered a "transfer" and subject to scrutiny to determine whether it was fraudulent with respect to other creditors.

When is a transfer of assets fraudulent as to a present or future creditor?

Basically, a transfer of assets (either real property or personal property) may be found to be fraudulent as to an existing or future creditor if either of two legal tests is met. The first test is whether the transfer was made with the actual intent to hinder, delay or defraud a creditor. The important part of this test is the phrase "actual intent." The reason this is critical is that there can be any number of plausible explanations for the transfer of asset. One such common explanation is that the transfer was made as part of the creditor's estate plan. What this means is that it can be difficult (and costly from the standpoint of legal fees) to prove "actual intent." Fortunately, Florida law provides certain factors which can support a finding of actual intent. They include:

- whether the transfer was to an insider;
- whether the debtor retains possession or control of the property after the transfer;
- whether the debtor attempted to conceal the transfer;
- whether the transfer occurred after the debtor was sued or otherwise faced collection of the debt;
- whether the debtor transferred all or substantially all of its assets; and

- whether the debtor was insolvent at the time of, or was made insolvent by, the transfer.

The second test requires a finding that the debtor made the transfer without receiving reasonably equivalent value for the asset and either (1) the debtor's remaining assets after the transfer are unreasonably small, or (2) the debtor intended to incur, or reasonably knew or should have known that he would incur, debts beyond his ability to pay.

When is a transfer of assets fraudulent as to a present creditor?

If the creditor's claim arises prior to the asset transfer, the creditor is deemed a "present" creditor. In that event, the transfer is fraudulent if the debtor (1) did not receive reasonably equivalent value for the asset and (2) the debtor was insolvent at the time of the transfer or was rendered insolvent by the transfer. There are other cases that may constitute fraudulent transfers as to present creditors but they are beyond the scope of this article.

What remedies does the creditor have?

Prior to looking ahead at potential remedies, the creditor must first successfully establish that a transfer was fraudulent. As you are by now aware, that is not necessarily easy and can be an

expensive proposition. Remember that the creditor will initially have the burden of showing that the transfer was fraudulent. If the creditor succeeds in that regard, the burden would shift to the debtor to defend the transfer by proving that it was not fraudulent. Assuming that the creditor ultimately prevails on that issue, there are multiple potential remedies, including setting aside the transfer thereby rendering the asset subject to the creditor's claim. Another remedy would be to obtain an injunction prohibiting the debtor from further transfers. The creditor might also obtain appointment of a receiver to take control of the assets in question.

How should a lender approach a suspected fraudulent transfer?

The lender can take steps to begin to identify suspect transfers. A comparison can be made between earlier and more recent financial statements and tax returns. It is a good idea to make financial disclosure part of any workout negotiation as you have a greater likelihood of the debtor cooperating in that stage of the loan. This information should be received

from all borrowers and guarantors. You can also conduct a search of the applicable real estate records to identify transfers of realty and also identify any properties that the borrower or guarantor still owns but has encumbered with a recent mortgage. Also, check the bank's account records to determine if any of the borrower's or guarantor's deposit accounts have been closed. If so, is there evidence of where the proceeds went? Again, the best time to begin collecting information that will help in analyzing transfers is at the time of a requested renewal or loan workout. Once litigation has commenced, borrowers typically will not cooperate. True, once the bank obtains a judgment, it can use the discovery procedure in litigation to access this type of information. Often, however, a good deal of time has elapsed and that can make it even more difficult to overturn a fraudulent transfer. Finally, note that there are statutes of limitation that apply to claims for fraudulent transfers. That means that there will be a point in time after which the creditor can no longer bring a claim. You should consult legal counsel in that regard as soon as you are aware of a suspect transfer.

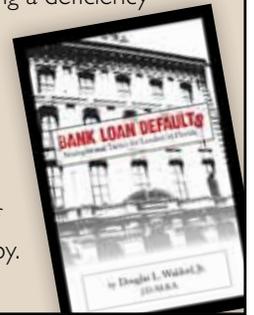
Mr. Waldorf is a Board Certified Real Estate Lawyer whose practice focuses on banking industry clients. He represents lenders in commercial and residential loan transactions, mortgage foreclosures, deeds in lieu of foreclosure, forbearance agreements, and defaulted loan workouts.



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Douglas Waldorf's first book, *Bank Loan Defaults: Strategies and Tactics for Lenders in Florida*, is now available. *Bank Loan Defaults* is a practical guide creditors need to consider when evaluating defaulted loans. From analyzing events of default, understanding how to foreclose a mortgage, obtaining a deficiency judgment and collecting a judgment, this book provides timely, real-world insight. Contact Attorney Waldorf to obtain your copy.



In the next issue of The Lender's Perspective we will address issues that lenders need to consider regarding development approvals on real estate collateral. Until then, thanks for reading!

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