

Indirect Benefits in Fraudulent Transfer Cases

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Submitted for the American Bankruptcy Institute Annual Spring Meeting - 2009

I. The General Rule

As a general rule, the debtor's payment of a debt of another is a constructive fraudulent transfer under 11 U.S.C. § 548(a) and the Uniform Fraudulent Transfer Act if the debtor was insolvent or was rendered insolvent by the transfer. *See, e.g., Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981); *In re Richards & Conover Steel, Co.*, 267 B.R. 602 (8th Cir. BAP 2001); *In re Art Unlimited, LLC*, 356 B.R. 700 (Bankr. E.D. Wi. 2006); *In re Keith Eickert Power Products, LLC*, 344 B.R. 685 (Bankr. M.D. Fla. 2006); *In re Galbreath*, 286 B.R. 185 (Bankr. S.D. Ga. 2002).

II. Indirect Benefits Cases

If the debtor's payment of the debt of another provided the debtor with an indirect benefit and the value of that benefit was reasonably equivalent to the debtor's payment, then the transfer was not a constructive fraudulent transfer.

A. Cases Finding That an Indirect Benefit Was Reasonably Equivalent Value

1. *In re Burry*, 309 B.R. 130 (Bankr. E.D. Pa. 2004). The debtor made some of the payments on a friend's boat loan, in exchange for which the owner allowed the debtor to use the boat. The court found that the debtor's payments on the owner's loan did indirectly benefit the debtor and that the debtor's payments were reasonably equivalent to the value of the debtor's use of the boat.
2. *In re Art Unlimited, LLC*, 356 B.R. 700 (Bankr. E.D. Wisc. 2006). The debtor's payments of the principal's debts did benefit the debtor, where the payment released security that the principal's creditor applied to pay the debtor's debt.
3. *In re Gerdes*, 246 B.R. 311 (Bankr. S.D. Ohio 2000). A creditor of the debtor's auto dealership held the title of a car as security for a debt of the dealership. After the dealership sold the vehicle, the debtor paid the dealership's debt to obtain a title from the creditor so that it could be delivered to the purchaser. The court found that the debtor benefitted from her payment of the debt to the dealership's creditor because of her potential personal liability for failure to deliver title and failure to pay the applicable sales tax. The court further found that this benefit was reasonably equivalent value.
4. *In re Gulf Northern Transport, Inc.*, 323 B.R. 786 (Bankr. M.D. Fla. 2005). The debtor paid the principal's debt on two trucks. The court found that the debtor benefitted from the use of one of the two trucks and that the value of the use was reasonably equivalent to the debtor's

payment on that truck. However, the debtor's payments on a second truck were avoided because the debtor did not have use of that truck.

5. *In re Jumer's Castle Lodge, Inc.*, 338 B.R. 344 (C.D. Ill. 2006). The debtor transferred assets to its shareholder as part of a sale and refinancing arrangement with a new investor. The court held that when evaluating whether the debtor received reasonably equivalent value, all of the value that the debtor received in the transaction had to be considered. The court found that the debtor received more in value than it transferred to its shareholder.

6. *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 63 (3d Cir. 1991). In a leveraged buy out, the debtor executed a guaranty and granted a security interest to the creditor that financed the acquisition of the debtor. The court stated:

The touchstone is whether the transaction conferred realizable commercial value on the debtor reasonably equivalent to the realizable commercial value of the assets transferred. Thus, when the debtor is a going concern and its realizable going concern value after the transaction is equal to or exceeds its going concern value before the transaction, reasonably equivalent value has been received.

Id. at 647.

The court found that the transaction allowed the debtor to borrow needed working capital, although it agreed that this value of this opportunity was difficult to quantify. The transaction also allowed the debtor and the acquirer synergies of business that enhanced the debtor's value, although again the court observed that this value was difficult to quantify. Ultimately, the court determined that the plaintiff had failed to establish that the transaction left the debtor insolvent, because in valuing the guarantees, plaintiff did not account for the value of other guarantees.

7. *In re Mid-South Auto Brokers, Inc.*, 290 B.R. 658 (Bankr. E.D. Ark. 2003). The debtor's principal borrowed funds to purchase a vehicle for the debtor's inventory. The debtor repaid the loan when it sold the vehicle. The court held that the debtor received reasonably equivalent value for its payment because the debtor had incurred a debt to the principal when the principal borrowed the funds to purchase the vehicle for the debtor in the first instance.

8. *In re NorthPoint Communications Group, Inc.*, 361 B.R. 149 Bankr. N.D. Cal 2007). The debtor paid an invoice from the defendant on construction debts owed to the defendant and third parties. The court held that the debtor did receive reasonably equivalent value for the payments made on account of the debts to the third parties because the defendant used the payment to pay the debtor's debts to those third parties.

9. *In re Richards & Conover Steel, Co.*, 267 B.R. 602 (8th Cir. BAP 2001). The debtor paid the attorney fees for a prepetition unofficial creditors committee that was formed to protect the creditors' interests during liquidation of the debtor's assets. The court held, "As a direct result of the efforts of [the attorneys], Rich-Con maximized its assets by collecting receivables and reducing its debts. Its fiscal situation was improved. Rich-Con received services of [the

attorneys] just as it would have if it had hired the firm directly. In this context, it makes no difference who hired the firm and who was ultimately responsible for paying its fees. [The attorneys] transferred value in the form of legal services to Rich-Con.” *Id.* at 613.

10. *In re Royal Crown Bottlers of North Alabama, Inc.*, 23 B.R. 28 (Bankr. N.D. Ala. 1982). The debtor- subsidiary paid a debt of its parent. The court held, “ if the debtor and the third party are so related or situated that they share an ‘identity of interests,’ because what benefits one will, in such case, benefit the other to some degree. The ultimate question then becomes one of determining the value of this vicarious benefit and testing it by the measure of ‘reasonably equivalent’ for the property transferred by the insolvent debtor.” *Id.* at 30. (Footnote omitted.) The court continued:

When the consideration for a transfer passes to the parent corporation of a debtor-sub subsidiary making the transfer, as in the case here, the benefit to the debtor may be presumed to be nominal, in the absence of proof of a specific benefit to it. On the other hand, the passing to a subsidiary of the consideration for a transfer by a debtor-parent may be presumed to be substantial, because the subsidiary corporation is an asset of the parent corporation, and what benefits the asset will ordinarily accrue to the benefit of its owner.

(Ultimately the court found that because the funds of the parent and subsidiary were commingled, the plaintiff could not establish that the payment sought to be recovered was a transfer of the debtor.)

11. *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981). The debtor was in the money order business and executed guarantees of its sales agents’ debts to the defendant. The court vacated the trial court’s finding of reasonably equivalent value, finding that the trial court had not quantified the value of the claimed indirect benefits. The court stated that the trial court “did not attempt to quantify the indirect benefits to either issuer or to compare those benefits with the obligations assumed by the issuers under the guarantees. Without such an analysis, it was impossible for the court to determine whether the estate of either issuer had been conserved[.]” *Id.* at 993. accordingly the matter was remanded with detailed instructions on how the trial court should conduct the analysis of reasonably equivalent value.

12. *In re Seaway Intern. Transport, Inc.*, 341 B.R. 333 (Bankr. S.D. Fla. 2006). The debtor made payments on the mortgage on the principal’s personal residence. The court found reasonably equivalent value because the mortgage payments were the principal’s only compensation.

13. *In re Wilkinson*, 196 Fed.Appx. 337 (6th Cir. 2006). The debtor paid for books sold to the debtor’s corporation for inventory. Because the payment reduced the debtor’s debt to his corporation, the court held there was reasonably equivalent value. The debtor’s insolvency at the time of the payment does not suggest otherwise.

B. Cases Finding That an Indirect Benefit Was NOT Reasonably Equivalent Value

1. *In re Keith Eickert Power Products, LLC*, 344 B.R. 685 (Bankr. M.D. Fla. 2006). The wife of the debtor's principal used the debtor's debit card for purchases of expensive clothing. The court found that the clothing was not of benefit to the debtor in its marine engine business.

2. *Pension Transfer Corp. v. Beneficiaries Under Third Amendment To Fruehauf Trailer Corporation Retirement Plan No. 003.*, 319 B.R. 76 (D. Del. 2005). The debtor amended its pension plan to increase the retirement benefits to its employees. The court held that this amendment was a transfer and that it did benefit the debtor in retaining employees. However, the court found that because the market cost of employee retention was 0.4% of sales and the cost of debtor's pension plan amendment was 0.8% of sales, the debtor did not receive reasonably equivalent value for its plan amendment..

3. *In re Galbreath*, 286 B.R. 185 (Bankr. S.D. Ga. 2002). The debtor signed note and security agreement to guaranty his corporation's preexisting debt. The court found that the debtor did not receive reasonably equivalent value because his net worth had not been preserved. The debtor's salary and use of car were not reasonably equivalent value because the debtor only became an employee after signing the guaranty.

4. *In re Johnson*, 357 B.R. 136 (Bankr N.D. Cal. 2006). The husband-debtor's corporation owed a debt on mechanic's lien. The debt was paid by the wife-debtor. The court found no benefit to the wife-debtor from this payment. (However, the court sustained the defendant's defense under § 550(b)(1).)

5. *In re Lockwood Auto Group, Inc.* 370 B.R. 652 (Bankr. W.D. Pa. 2007). The debtor granted a security interest in certificate of deposit to secure a loan to the debtor's shareholder. The court did not consider that this security interest was part of a refinancing transaction that allowed the debtor to remain in business and found that the debtor received no value for the transfer.

6. *In re Nat. Century Financial Enterprises, Inc.*, 341 B.R. 198 (Bankr. S.D. Ohio 2006). The debtor paid the defendant for software licenses used by third parties. The court held that the plaintiff met its burden of showing no direct benefit and then analyzed whether the defendants met their burden of showing indirect benefits to the debtor. The court held that an undocumented promise to the debtor to pay the debts of its subsidiaries was worthless because of that party's own insolvency. *See also, Cent. Bank of Cleveland v. Coleman (In re B-F Bldg. Corp.)*, 312 F.2d 691, 694 (6th Cir.1963) (worthless demand promissory note issued by insolvent entity did not provide reasonably equivalent value). *See also Frank v. Kiesel (In re Denison)*, 292 B.R. 150, 154 (E.D.Mich.2003) ([A] future return on an investment could constitute reasonably equivalent value for the initial purpose, [but] there must be some legitimate and reasonable chance of return.) (quoting *Mellon Bank, N.A. v. Official Comm. of Unsecured Creditors of R.M.L. (In re R.M.L., Inc.)*, 92 F.3d 139, 152 (3rd Cir.1996)). The court further found no other "concrete, identifiable" indirect benefit.

7. *In re R.M.L., Inc.*, 92 F.3d 139 (3d Cir. 1996). The debtor paid a deposit and fees to the defendant for a failed loan commitment. The court affirmed the trial court's finding that the

debtor received no indirect benefits from these payments. Other creditors had agreed to extend credit terms, but not as a result of the defendant's commitment letter.

(In analyzing whether the debtor received any direct benefit, the court held that the failure of the loan was not grounds to find that there was no reasonably equivalent value. Rather, "so long as there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer, we will find that value has been conferred." *Id.* at 152. The court affirmed the trial court's finding that because there was little chance that the loan proposed in the commitment letter would close, it was not of reasonably equivalent value.)

8. *In re Solomon*, 299 B.R. 626 (10th Cir. BAP 2003). The debtors granted two mortgages to secure their previously unsecured guaranty. The court sustained the trial court's finding of no reasonably equivalent value.

9. *In re Southern Health Care of Arkansas, Inc.*, 309 B.R. 314 (8th Cir. BAP 2004). The debtor made the mortgage payments on behalf of a third party. The court sustained the trial court's finding of no reasonably equivalent value.

See also SPC Plastics Corp. v. Griffith (In re Structurelite Plastics Corp.), 224 B.R. 27, 31 (6th Cir. BAP 1998)) (noting that the speculative value of indirect benefits like the opportunity to acquire additional loans or new managerial talent does not constitute fair consideration); *Clark v. Sec. Pac. Bus. Credit (In re Wes Dor, Inc.)*, 996 F.2d 237, 243 (10th Cir. 1993) (To the extent indirect benefits could be considered . . . the Bank fails to point to any evidence quantifying the amount of such benefits.)

III. Burden of Proof in Indirect Transfer Cases

There is substantial authority that in an indirect transfer case, once the plaintiff has shown that the transfer was for the benefit of a third-party, the burden shifts to the defendant to prove that the debtor received reasonably equivalent value indirectly as a result of the transfer. *See, e.g.:*

First Nat'l Bank in Anoka v. Minn. Utility Contracting, Inc. (In re Minn. Utility Contracting, Inc.), 110 B.R. 414, 419 (D. Minn. 1990).

Braunstein v. Walsh (In re Rowanoak Corp.), 344 F.3d 126, 131-32 (1st Cir. 2003) ([o]nce the Trustee establishes his prima facie case, he need not affirmatively disprove every other potential theory).

In re Richards & Conover Steel, Co., 267 B.R. 602, 614 (8th Cir. BAP 2001) ([party claiming to have delivered value must quantify it.]).

Commerce Bank of Kansas City, N.A. v. Achtenberg, 1993 WL 476510, *3 (W.D. Mo. 1993) ([T]he court's rationale in *Minnesota Utility* is well reasoned and fully supported by other courts and commentators interpreting § 548(a)(2).).

Leonard v. Mountainwest Fin. Corp. (In re Whaley), 229 B.R. 767, 775 (Bankr. D. Minn. 1999) (where immediate benefit from transfer goes to third party, burden shifts to transferee to show debtor received indirect benefit that was both tangible and of concrete economic value).

Leonard v. First Commercial Mortgage Co. (In re Circuit Alliance, Inc.), 228 B.R. 225, 231 (Bankr. D. Minn. 1998) (when trustee establishes transfer was made on account of third party's debt or obligation, burden shifts to defendant to demonstrate debtor received benefit that was tangible, of concrete economic value, and reasonably equivalent to what the debtor gave up.).

Leonard v. Norman Vinitzky Residuary Trust (In re Jolly's Inc.), 188 B.R. 832, 843 (Bankr. D. Minn. 1995) (once proven that consideration for transfer went directly to third party, defendant seeking shelter of indirect benefit defense bears intermediate burden of *production* as to the concreteness of the indirect benefit, and its reasonable equivalence in value. (emphasis in original)).

In re Nat. Century Financial Enterprises, Inc., 341 B.R. 198 (Bankr. S.D. Ohio 2006) (once "a plaintiff has established that consideration for the transfer passed to a third-party, the burden of demonstrating and quantifying reasonably equivalent value for the transfer shifts to the defendant.").

In re Dayton Title Agency, Inc., 292 B.R. 857 (Bankr. S.D. Ohio 2003).