ASSET PROTECTION:
THE BAPCPA AMENDMENTS

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The "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" added two new provisions to the Bankruptcy Code concerning asset protection. This article will discuss these two provisions and the cases that have interpreted them.

I. SUBSECTION 522(o)

A. The Statute

New 11 U.S.C. § 522(o) provides, "For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in--

(1) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

(3) a burial plot for the debtor or a dependent of the debtor; or

(4) real or personal property that the debtor or a dependent of the debtor claims as a homestead, shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of."

This provision reduces the value of the interest in which a debtor can claim a homestead, based on the debtor

disposing of nonexempt property during the 10 years prior to the petition date with intent to hinder, delay, or defraud a creditor. The 10 year look back period is far longer than anything that was in the Bankruptcy Code prior to BAPCPA.

B. **The Cases Interpreting the Statute**

It has quickly become accepted that, while Congress did not provide any guidance for the interpretation of the phrase "with the intent to hinder, delay, or defraud a creditor", courts will look to the well established body of case law interpreting that phrase under 11 U.S.C. § 727(a)(2)(A), with an approach based on the presence of "badges of fraud." *In re Addison*, 540 F.3d 805 (8th Cir. 2008). Prior to BAPCPA it was well established that converting nonexempt assets into exempt assets on the eve of bankruptcy was not in and of itself objectionable and was not sufficient to show an intent to hinder, delay, or defraud a creditor, without the presence of sufficient badges of fraud. Recent cases hold that § 522(o) does not change these rules.

For example, in *In re Agnew*, 355 B.R. 276 (Bankr. D. Kan. 2006), the debtor had lived on a farm he leased from his mother's trust. Five days before the petition, and while creditors were suing him, he traded an undivided one-fifth interest in some farmland and his farm equipment to his mother's trust in exchange for the farm, and he then leased back the traded farmland and equipment. The Court found that even though the conversion of nonexempt assets to exempt was done in a transaction with an insider during a time the debtor was being pursued by creditors, and even though the debtor retained control of his former property after the trade, those badges of fraud were not enough to show the debtor had acted with the requisite intent to hinder, delay, or defraud a creditor. The Court said the trade pursued a legitimate estate planning purpose that had been discussed for three years before the exchange, in that the debtor's 90 year old mother did not want the debtor's siblings to get control of the farm after the mother's death. Therefore §

522(o) was found not to apply. The same result was reached in *In re Gjullin*, 2006 Bankr. LEXIS 3215 (Bankr. D. Mont. 2006), where the debtor had consulted a bankruptcy attorney and then sold a pickup truck and used the proceeds to purchase a mobile home; the Court found that the transaction was done because the debtor "needed a home more than he needed the expense of maintaining full insurance coverage for a parked pickup that he was not using".

On the other hand, if there is some misconduct or sharp dealing that a court can attribute to the debtor along with the conversion of nonexempt assets into exempt assets, then a § 522(o) objection will likely be sustained. In *In re Maronde*, 332 B.R. 593 (Bankr. D. Minn. 2005), the debtor sold a truck and a trailer during the three weeks prior to filing bankruptcy and used the proceeds to pay off the second mortgage on his home. The Court found that these transactions were part of a scheme to hinder creditors, because prior to these sales the debtor had been taking cash advances on his credit cards and using those funds to pay down his home mortgage, and it applied § 522(o). In *In re Keck*, 363 B.R. 193 (Bankr. D. Kan. 2007), the debtor methodically used large cash advances taken from various credit card companies to both make improvements on and pay off the mortgages on his home, and again, the Court found this misconduct sufficient to apply § 522(o). The misconduct needs to be toward multiple creditors and/or be recent in time, however; in *In re Fehmel*, 2008 Bankr. 2577 (Bankr. W.D. Tex. May 22, 2008), the debtors two years prior to the petition date took over $73,000 from their corporation's line of credit and used the money as a down payment to buy a house, in blatant violation of the bank's rules regarding the line of credit, yet the Court found the debtors did not have actual intent to hinder, delay, or defraud their creditors within the meaning of § 522(o).

Concealment of the transfers can also be a badge of fraud that leads to the application of § 522(o). In *In re Sissom*, 366 B.R. 677 (Bankr. S.D. Tex. 2007), the debtor

sold stock, put the money into cashier's checks that his wife held for a number of weeks, and then used some of the money to purchase a property that later became his home. He failed to disclose these transactions in his statement of financial affairs. The Court found such concealment critical in finding an intent to hinder, delay, or defraud creditors. In *In re Presto*, 376 B.R. 554 (Bankr. S.D. Tex. 2007), the debtor, a former vice president of Enron, used proceeds from a sale of other real estate to make improvements on his home, and he did not disclose those transactions in his statement of financial affairs. Again, the Court was particularly troubled by the nondisclosure, and found § 522(o) applicable.

Where courts have found the analysis a close call and have reached divergent results is where a debtor on the eve of bankruptcy sells a substantial nonexempt asset and uses it for a massive pay down of the home mortgage. In *In re Lacounte*, 342 B.R. 809 (Bankr. D. Mont. 2005), the debtors sold three vehicles and a one-third remainder interest in a farm during the four months prior to filing bankruptcy, and used virtually all of the proceeds to pay down their home mortgage. The Court did not believe testimony that the debtors had acted out of concern for their retirement (among other reasons because the funds were not used to repay a loan against a retirement plan), found that the purpose of the transactions was to divert funds away from their creditors, and concluded that such purpose was sufficient to trigger § 522(o). On the other hand, in *In re Anderson*, 386 B.R. 315 (Bankr. D. Kan. 2008), the debtor took multiple cash and real estate assets totaling $240,000 and used that money to pay down his home mortgage. The Court found that even though he was being sued by a creditor at the time, the debtor did not conceal the transactions and disclosed them in his statement of financial affairs. The Court said that without something more than pre-bankruptcy planning, there would be no allowable § 522(o) objection.

Two recent appellate cases on § 522(o) in the Eighth Circuit hold that the statue requires more than just the eve of

bankruptcy transfer of nonexempt assets into the exempt homestead. In *Addison*, the Eighth Circuit Court of Appeals reversed a determination by a bankruptcy court and bankruptcy appellate panel that a mortgage payment of $11,500 on the day of a bankruptcy filing triggered § 522(o). In *In re Wilmoth*, 397 B.R. 915 (8th Cir. BAP 2008), the Eighth Circuit Bankruptcy Appellate Panel affirmed a determination by a bankruptcy court that a sale of 9 or 10 pieces of equipment based on the advice of a bankruptcy lawyer and from which over $140,000 was used to pay down a mortgage was not subject to § 522(o). Indeed, the *Wilmoth* panel stated that § 522(o) did not change anything about the law regarding pre-bankruptcy exemption planning but merely increased the look-back period to 10 years.

The effect of the application of § 522(o) in *Maronde* is instructive. The relevant state law homestead exemption amount was $200,000. The debtor's home had equity of $69,572. The amount that was found to be subject to § 522(o) by being paid on the second mortgage was $18,750.46. The Court did not hold that the applicable homestead exemption was reduced from $200,000 by $18,750.46 to $181,249.54. Rather, it held that $18,750.46 of the equity in the home was nonexempt, so that a Chapter 13 plan could not be confirmed unless it paid creditors at least $18,750.46 plus the value of other non-exempt assets. Critical to this result was that the non-exempt funds transferred into the home were used to pay down a mortgage, and thus increased the debtor's equity dollar for dollar. In *Presto* the transfers into the home were used for improvements rather than for mortgage payments. The Court found that the nonexempt amount under § 522(o) was not the cost of the improvements, but rather the amount by which the improvements increased the market value (and hence the debtor's equity) in the home.

Important to any discussion of § 522(o) is that it applies only to homestead exemptions taken pursuant to § 522(b)(3)(A), i.e. state law homestead exemptions. The

Bankruptcy Code separately permits an exemption in tenancy by the entirety property in certain circumstances under § 522(b)(3)(B), and § 522(o) has no effect at all on such exemptions claims. *In re Hinton*, 378 B.R. 371 (Bankr. M.D. Fla. 2007); *In re Zolnierowicz,* 380 B.R. 84 (Bankr. M.D. Fla. 2007)

A final case of interest regarding § 522(o) is *In re Lyons*, 355 B.R. 387 (Bankr. D. Mass. 2006) (Rosenthal, J.). In *Lyons* the argument was made that the recording of a declaration of homestead during the 10 years prior to the petition date triggered § 522(o). The Court disagreed, holding that the recording of a declaration of homestead did not constitute any "disposition" of property, making § 522(o) inapplicable irrespective of the debtor's intention.

II. SUBSECTION 548(e)

A. **The Statute**

New 11 U.S.C. § 548(e) provides, "(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—

(A) such transfer was made to a self-settled trust or similar device;

(B) such transfer was by the debtor;

(C) the debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer 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, indebted.

(2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would

be incurred by—

(A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c (a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or

(B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l and 78o (d)) or under section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

This new provision creates a 10 year look back period for certain transfers made with actual fraudulent intent. The transfer must be to a "self-settled trust or similar device", a term which, notably, is not defined in the Bankruptcy Code. The provision has an illustrative list of transfers that might be avoidable, such as transfers in anticipation of the entry of a money judgment against the debtor or the imposition of penalties or fines under the securities laws, but the list is not limiting given the use of the word "includes".

B. **The Cases Interpreting the Statute**

The statute has been said to be "a reaction to state legislation overturning the common law rule that self-settled spendthrift trusts may be reached by creditors (and thus also by the bankruptcy trustee)." 5 *Collier on Bankruptcy* ¶ 548.09A[3][a] (Lawrence P. King et al. eds., 15th ed. rev. 2009). The legislative history of BAPCPA includes a statement noting that "five States, Alaska, Delaware, Nevada, Rhode Island, and Utah, have enacted laws that permit their citizens to establish self-settled trusts where they can place their assets outside the reach of their creditors." H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 449 (2005). Nevertheless, no reported cases under § 548(e) address self-settled trusts created under the laws of these states.

The only reported case addressing in any detail whether a transfer was made to a "self-settled trust or similar device" within the meaning of § 548(e) is *In re Potter*, 2008 Bankr. LEXIS 3351 (Bankr. D.N.M. 2008). The debtor in *Potter* had, along with two limited liability companies, transferred assets into a trust of which he was one of the beneficiaries. The debtor argued that the trust did not fall into § 548(e) because of the presence of other beneficiaries and because of the transfers by the limited liability companies. The Court held, however, that § 548(e) applied as long as the debtor was "a" beneficiary, and did not have to be "the" beneficiary, and further held that the transfers into the trust (including those from the limited liability companies) were all by the debtor because the debtor was the sole member of the first limited liability company and that limited liability company was the sole member of the second limited liability company. Given the existence of many badges of fraud in connection with the transfer to the trust, in particular that the trust was formed shortly after a $600,000 judgment was entered against the debtor, the Court granted summary judgment in favor of the trustee under § 548(e).

In *In re Krause*, 2007 Bankr. LEXIS 4068 (Bankr. D. Kan. 2007), the trustee challenged numerous transfers made by a debtor into various "children's irrevocable" trusts. The debtor moved for summary judgment on the grounds that § 548(e) did not apply because he was not a beneficiary of the trusts. The Court denied summary judgment, holding that there were genuine issues of material fact as to whether the trusts were "similar devices" to self-settled trusts and whether the debtor was in fact the true beneficiary. It is unclear from the opinion whether the trustee actually would need § 548(e) to prevail, since if the debtor was in fact the true beneficiary of the trust then the common law would seemingly prevent the spendthrift clause of the trust from being enforceable.

Finally, in *In re Combes*, 382 B.R. 186 (Bankr. E.D.N.Y. 2008), the trustee challenged the purchase of two

annuities by the debtor as transfers avoidable under § 548(e). The Court found that the debtor was solvent at the time of the purchase of the annuities and that she did not act with actual intent to hinder, delay, or defraud creditors. The Court did not address whether a purchase of an annuity could constitute a transfer to a "self-settled trust or similar device".