

Alert

Tenth Circuit Quashes Fraudulent Transfer Suit Against Asset Buyer

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An undersecured mortgagee's "release of [its entire underlying claim] was value obtained 'in exchange for' the [pre-bankruptcy] sale of the [debtor's] property," held the U.S. Court of Appeals for the Tenth Circuit on Dec. 6, 2016. *In re Expert South Tulsa LLC*, 2016 U.S. App. LEXIS 21704, at *11 (10th Cir. Dec. 6, 2016). The Tenth Circuit flatly rejected the debtor's attempt "to set aside as a fraudulent transfer its own sale of real estate that was encumbered by a mortgage far exceeding the sale price." *Id.* at *1. Affirming the lower courts, the court stressed the extraordinary value to the debtor of the undersecured lender's "dismiss[al] with prejudice [of] its claims under the mortgage and the mortgage note." *Id.* at *9.

Relevance

A number of appellate courts have, within the past year, analyzed "value" in the fraudulent transfer context. See, e.g., *In re PSN USA, Inc.*, 615 F. App'x 925 (11th Cir. 2015) (insolvent corporate subsidiary's payment of parent's contractual obligations not a fraudulent transfer when "the [subsidiary] Debtor received reasonably equivalent value in exchange for [its cash] transfers."); *Janvey v. Golf Channel, Inc.*, 487 S.W. 3d 560 (Tex. 2016) ("reasonably equivalent value" as defense to fraudulent transfer suit "can be satisfied with evidence that the transferee (1) fully performed under a lawful, arm's-length contract for fair market value, (2) provided consideration that had objective value at the time of the transaction, and (3) made the exchange in the ordinary course of the transferee's business ... [V]alue is value regardless of whether the debtor is insolvent ... "); *Janvey v. Golf Channel, Inc.*, 834 F.3d 570, 573 (5th Cir. 2016) (affirmed dismissal of receiver's fraudulent transfer suit against advertising firm for \$5.9 million received in good faith from Ponzi scheme debtor; district court found debtor had received market value of advertising services and that defendant "looks more like an innocent trade creditor ... ").

"Value," for purposes of Bankruptcy Code ("Code") § 548, "means property, or satisfaction or securing of a present or antecedent debt of the debtor" A trial court's finding of value is a factual matter. *In re Fruehauf Trailer*, 444 F.3d 203, 214 (3rd Cir. 2006) (plaintiff must prove that value of intangible benefit is zero); *1756 W. Lake St LLC v. Am. Chartered Bank*, 787 F.3d 383, 387 (7th Cir. 2015) (court approximated value of benefit); *Creditors' Comm. of Jumer's Castle Dodge v. Jumer*, 472 F.3d 943, 947 (7th Cir. 2007) (court must "determine the value of what was transferred and ... compare it to what was received."). When the transferee is a creditor, the debtor receives value for the transfer only if it satisfies part or all of the transferee-creditor's claim against the debtor. *Id.*

Facts

The debtor owned a parcel of real estate subject to a \$7.75-million mortgage and other liens totaling roughly \$500,000. After defaulting on the mortgage loan, the debtor chose to find a buyer for the

property rather than defend a foreclosure action brought by the mortgagee. It eventually found a buyer, C, who paid \$3 million “contingent on delivery of free and clear title.” At the closing, the purchase price was distributed as follows: \$1.74 million to the mortgagee; \$115,000 to other lienholders; \$686,000 to the debtor’s unsecured creditors; and \$261,000 to the debtor. C then sold the property “for \$4.4 million only eleven days after closing,” a troubling fact for the debtor. 2016 U.S. App. LEXIS 21704, *Id.* at *3.

An unpaid creditor later forced the debtor into bankruptcy involuntarily, but the debtor promptly converted the case to Chapter 11 and sued C to avoid the property sale, alleging a fraudulent transfer because it had “not receive[d] reasonably equivalent value for the property.” *Id.* at *4. The bankruptcy court granted summary judgment dismissing the debtor’s suit and the Tenth Circuit Bankruptcy Appellate Panel affirmed.

Tenth Circuit Analysis

The debtor asserted “two claims of fraudulent or constructively fraudulent transfer against” C under federal and state law. *Id.* at *4. Both claims “require that a transfer of property by [the debtor] have been for less than reasonably equivalent value.” *Id.* See Code § 548(a)(1)(B) (transfer voidable if made “within two years before the filing of the bankruptcy petition” and the debtor “received less than a ‘reasonably equivalent value’ in exchange for the transfer” while insolvent).

Test for Determining Value

Noting that “fraudulent-transfer statutes are for the protection of unsecured creditors,” the court “measure[d] the value received in terms of the effect on those creditors.” *Id.* at *5. Significantly, “value” includes more than the exchange of cash, but also includes “satisfaction ... of a present or antecedent debt of the debtor.” *Id.* at *6, citing Code § 548(d)(2)(A) and Oklahoma’s Uniform Fraudulent Transfer Act. When a debt is extinguished, reasoned the court, “the remaining creditors benefit because the satisfied creditor is no longer competing for the debtor’s property.” *Id.*

Application of Law to Facts

The debtor here not only received part of the \$3-million purchase price from the sale, but also obtained the “release of the more than \$6 million it would still owe on the mortgage loan.” *Id.* at *7. According to the Tenth Circuit, “it is obvious that Debtor received at least reasonably equivalent value for the property if the obligation was released (the amount due on the note, \$7.75 million, is more than reasonably equivalent to \$4.99 million [the property’s asserted value]) ... ” *Id.* Nor could there be any question that the debtor had been released. “The mortgagee ended the litigation by filing a dismissal with prejudice, stating that it ‘hereby dismisses all claims or counterclaims, against all other parties, with prejudice.’” *Id.* The dismissal thus released the debtor from all of its obligations on the mortgage. *Id.* at *8. When the mortgagee “dismissed its claims with prejudice, it ... was barred from litigating them later.” *Id.* at *9-*10.

The court also dismissed the debtor’s argument that the mortgagee’s release of its debt was not “‘in exchange for’ the property it sold,” and, therefore, not value received as “part of the deal.” *Id.* at *10. Finding that “extinguishment of the debt” was simultaneous with the rest of the deal and no reasonable factfinder could find that the extinguishment was an act of generosity divorced from the overall deal, the court concluded “[s]imply put, the sale was undoubtedly a but-for cause of the extinguishment of the debt.” *Id.* at *10-11.

Comment

The debtor's suit was based on envy. The debtor may have regretted the sale of its property for \$3 million when the buyer promptly resold it for almost a 50-percent profit, but it overlooked what it received — the release of a \$7.75-million claim plus \$261,000 in cash. That was enough and more than “reasonably equivalent.”

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