



# THE ENFORCER

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## Spouses Who Play Hide And Seek With Their Assets

Occasionally enforcement work has its ironic moments. Mr. K, was skilled at hiding assets (and debts) from his former wife during their marriage. Mr. K artfully employed those skills when I was appointed as receiver to enforce a property settlement. Contact with multiple banks and investment firms revealed that Mr. K had closed out his many accounts, and there the trail stopped cold. He remarried, and it was suspected that he had transferred his assets to his new wife. Then, Mr. K's new wife filed for divorce, and suddenly Mr. K was willing to talk about what he did with his money. Why? Because he *did* transfer his secreted assets from his first marriage to his second wife in an effort to avoid collection. Now that the second Mrs. K was divorcing him, Mr. K wanted his assets back. Poetic irony? Perhaps.

During a very frank meeting, Mr. K detailed how he had systematically closed his accounts and took the cash, or cashier's checks, and deposited them into a regular bank account in his second wife's name. (Usually it's the jilted former lover who is spilling the beans, not the transferor). He then established internet accounts, again in her name, and transferred the funds from the general bank account into the internet bank accounts. He also purchased vehicles in her name. He has documentation. According to Mr. K, the second Mrs. K did know that he was transferring assets into in her name.

Tracing the assets fraudulently transferred by Mr. K in his admitted effort to avoid collection was the hard work. It could be that some of those transferred assets are determined to be assets of his second marriage, like the interest earned in those accounts. Funds could have been commingled. Complexities aside, how can the transferred assets to be recovered? What if she has transferred them to another family member who did not know about the fraud? Can they still be recovered?

## The Uniform Fraudulent Transfer Act

MCL 566.31 et seq. is the Uniform Fraudulent Transfer Act (the "Act"), which was established to define and regulate fraudulent transfers and conveyances and to provide a remedy to set aside those transfers.

The Act sets forth two types of fraudulent transfers:

1. a *transfer with the intent to defraud* (MCL 566.34) as well as
2. a *transfer by debtor as fraud* (MCL 566.35).

A transfer is made with the intent to defraud under MCL 566.34, if:

1. A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation in either of the following:
  - a. With actual intent to hinder, delay or defraud any creditor of the debtor.
  - b. Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor did either of the following:
    - i. Was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction.
    - ii. Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.



Further, MCL 566.34(2)(a)-(k) enumerates a series of eleven non-exclusive factors to be considered by a Court in determining whether there was actual intent to defraud. The second category under the Act, transfer by a debtor as fraud, requires a clearer indication of bad action:

1. A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.
2. A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent. (MCL 566.35)

Under both MCL 566.34 and 566.35, there are two basic elements that a court must use to determine if a transfer is fraudulent as to a creditor:

1. The transfer must be without *fair consideration (transfer for value)*(MCL 566.33);
2. The transfer must: occur when the transferor is *insolvent* or render the transferor *insolvent*. (MCL 566.32).

### **Transfer For Value**

The Act's definition of a transfer for value (fair consideration) is found at MCL 566.33:

- a. Value is given for a transfer or an obligation, if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied. Value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person.
- b. For the purposes of sections 4(a)(2) and 5, a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

- c. A transfer is made for present value if the exchange between the debtor and the transferee is intended by them to be contemporaneous and is in fact substantially contemporaneous.

### **Insolvency**

MCL 566.32 defines ***insolvency*** as:

1. A person is insolvent if the sum of the debtor's debts is greater than the all of the debtor's assets at a fair valuation.
2. A debtor who is generally not paying his or her debts is presumed to be insolvent.

\* \* \*

After a transfer, the debtor is insolvent if: "...the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." (MCL 566.32(1)). In the case detailed above, Mr. K did render himself insolvent. Further, he is presumed insolvent because he did not pay his debts as they become due. His failure to pay anything toward the property settlement in the Judgment of Divorce would require that a court presume that Mr. K. is insolvent (MCL 566.32(2)).

### **Remedies Under The Uniform Fraudulent Transfer Act Including Recovery From Subsequent Transferees**

The Act provides multiple remedies at MCL 566.37, including avoidance of the transfer or attachment of the asset to the extent necessary to satisfy the creditor's claim, an injunction against further disposition of the transferred asset, appointment of a receiver, or levy and execution of the transferred asset or its proceeds. Further, a judgment may be obtained against the transferee (or any subsequent transferee) for the value of the asset transferred or the amount necessary to satisfy the creditor's claim, whichever is less.

Under MCL 566.38(2) of the Act, a creditor may seek recovery against:

1. the first transferee of the asset (MCL 566.38(2)(a));
2. the person for whose benefit the transfer was made (MCL 566.38(2)(a)); or
3. any subsequent transferee other than a goodfaith transferee who took for value or from any subsequent transferee. (MCL § 566.38(2)(b)).

For example, assume that a support payer, who has a substantial arrearage, transfers his home to his mother with the stated consideration on the deed of \$1.00. She then transfers it to her sister with the same consideration. Under MCL 566.38(2)(b), the support payee could seek recovery of the property from the support payer's aunt unless she can demonstrate that took title while acting in good faith and that she paid value.

### **In Pari Delicto And The Wrongful Conduct Rule**

The in pari delicto defense and an explanation of the wrongful conduct rule was best articulated in *MCA Financial Corp. v. Grant Thornton*, 263 Mich. App. 152 (2004). In *MCA*, the company operated a Ponzi scheme centered around selling interests in mortgages and land contracts. Like all Ponzi schemes, the *MCA* Ponzi scheme collapsed. A Chapter 11 liquidating agent was subsequently appointed. The liquidating agent brought an action on behalf of the corporations (which operated the Ponzi) against *MCA's* accountants for failing to report accounting irregularities that would have disclosed the Ponzi scheme and lessened the financial losses. The court denied the relief sought because the corporations were responsible for the Ponzi scheme and on whose behalf the liquidating agent was seeking recovery.

When a plaintiff's action is based, in whole or in part, on his own illegal conduct, a fundamental commonlaw maxim generally applies to bar the plaintiff's claim:

"[A] person cannot maintain an action if, in order to establish his cause of action, he must rely, in whole or in part, on an illegal or immoral act or transactions to which he is a party."

When a plaintiff's action is based on his own illegal conduct, and the defendant has participated equally in the illegal activity, a similar commonlaw maxim, known as the "doctrine of in pari delicto" generally applies to also bar the plaintiff's claim:

"[A]s between parties in pari delicto, that is equally in the wrong, the law will not lend itself to afford relief to one as against the other, but will leave them as it finds them."

Id at 156. (Citations omitted).

Based on the in pari delicto rule, Mr. K could not bring a fraudulent transfer action against the second Mrs. K. However, nothing bars the first Mrs. K from bringing an action against the second Mrs. K to recover the assets transferred.

### **Conclusion**

Factually, the scenarios set forth in this article are part and parcel of family practice. One would be hard pressed to meet a family practitioner or judge who has not seen a fraudulent transfer. Knowledge of the Act is another arrow that all of us should have in our quivers.

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