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# Fraudulent Transfers and Divorce Settlements

**by Alan C. Eidsness and Jaime Driggs**

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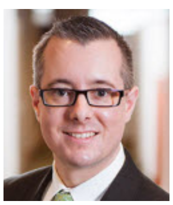

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Minnesota's Uniform Fraudulent Transfer Act ("MUFTA") is not a common consideration when advising marital dissolution clients. But a decision from the Minnesota Supreme Court holding that MUFTA applied to transfers made pursuant to an uncontested dissolution decree means that MUFTA is something to be aware of in situations where one of the parties is facing a significant creditor.

In Citizens State Bank Norwood Young Am. v. Brown, 849 N.W.2d 55 (Minn. 2014), husband guaranteed loans made to two businesses. On January 8, 2010, the bank sued husband to enforce the personal guarantees after the businesses defaulted on the loans. Husband commenced a marriage dissolution proceeding on March 15, 2010. A default judgment was entered against husband and in favor of the bank on June 29, 2010. Husband and wife signed a Marital Termination Agreement ("MTA") on October 5, 2010 and the dissolution decree was entered on October 13, 2010.

The decree awarded husband the parties' homestead (valued at $421,900), his 1999 Cadillac (not valued), his 401(k) (valued at less than $140,000), a checking account (valued at less than $3,000), and corporate stock (valued at less than $80,000). The decree made husband solely responsible for the parties' joint debts of more than $270,000 and made husband solely responsible for his personal guarantee obligations of approximately $8.8 million.

The decree awarded wife an investment account that had been solely in husband's name (valued at $1.2 million) and husband's 50% interest in a partnership (valued at $300,000). These two assets secured a loan to a different lender of $1.1 million. The decree also awarded wife a savings account in her name (valued at $84,000).

After the divorce, husband and wife continued to live together in the marital homestead that husband had been awarded. When the bank could not collect on its judgment against husband, it brought an action under MUFTA to go after the assets that husband had transferred to wife under the decree. The bank's motion for summary judgment was granted by the district court based on the existence of a number of "badges of fraud," the factors under MUFTA used to evaluate whether a transfer was made with a fraudulent intent. Husband and wife appealed and the Court of Appeals affirmed.

The first issue decided by the Supreme Court was whether MUFTA had any application at all in this context. The Court held that MUFTA's broad definition of "transfer" encompassed transfers made pursuant to uncontested marital dissolution decrees, a result consistent with that reached by several other states.

The Court then reviewed whether summary judgment was properly granted by analyzing a number of badges of fraud: (1) "the transfer . . . was to an insider"; (2) "the transfer was of substantially all the debtor's assets"; (3) the debtor failed to receive reasonably equivalent value for the asset transferred or obligation incurred; (4) "the debtor was insolvent or became insolvent shortly after the transfer was made"; (5) "before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit"; (6) "the transfer occurred shortly before or shortly after a substantial debt was incurred"; and (7) "the debtor retained possession or control of the property transferred after the transfer." Minn. Stat. § 513.44(b).

In considering whether the transfers were to insiders, the Court explained that the relevant point in time is when the transfer is "so far perfected that a creditor on a simple contract cannot acquire a judicial lien" absent MUFTA. This occurred when the dissolution decree was entered and not when the parties signed their MTA (when they were still spouses and insiders). Because the decree also dissolved the parties' marriage, the parties were not spouses at the time of the transfer. However, because people living together and having a close relationship can constitute insiders under MUFTA, the parties were nonetheless insiders even if they were no longer spouses at the time of the transfer. They had been married for 23 years before the dissolution and continued to live together in the homestead thereafter. The parties presented no evidence to support their assertion that they were living together only because of financial considerations.

Husband challenged the district court's determination that he had transferred substantially all of his assets in the dissolution because he retained the homestead valued at $421,900 and his 401(k), valued at less than $140,000. The Supreme Court agreed with the district court because "assets" are defined by MUFTA to exclude "property to the extent it is generally exempt under nonbankruptcy law." Minn. Stat. § 513.41(2)(ii). Because Husband's 401(k) was exempt, it was not an asset. And because $360,000 of the homestead was exempt, its value was only $61,900. Also, this remaining value of the homestead also did not count as husband's asset because in 2009 husband had signed a quit claim deed transferring his interest to wife. Under the Court's analysis, husband had nonexempt assets before the dissolution consisting of his checking account ($3,000), corporate stock ($80,000), investment account ($1.2 million), and a partnership interest ($300,000). Because husband transferred the investment account and partnership interest to wife while retaining only his checking account and corporate stock, he had transferred substantially all of his assets.

The same analysis regarding exempt property drove the inquiry of whether husband had received reasonably equivalent value for the assets he transferred. In exchange for the assets totaling $1.5 million husband transferred to wife, husband received the homestead which had a nonexempt value of only $61,900. Based on this disparity and husband's agreement to be responsible for the parties' joint debts of $270,000, husband did not receive reasonably equivalent value for the assets he transferred to wife.

Next, the Court evaluated whether "the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred." Husband was insolvent after the dissolution because his nonexempt assets were less than the $270,000 debt he took on even without considering the personal guarantee obligations.

There was no dispute that husband had been sued or threated with a lawsuit at the time of the transfer in October 2010 because the bank had commenced suit in January 2010.

The Court then considered whether the transfers "occurred shortly before or shortly after a substantial debt was incurred." For purposes of this analysis, the debt was incurred on June 29, 2010 when the default judgment was entered against husband. The transfers occurred shortly after this on October 13, 2010 when the dissolution decree was entered.

Finally, the Court considered whether "the debtor retained possession or control of the property transferred after the transfer." The bank submitted evidence showing that several months after entry of the dissolution decree in October 2010, husband's name was continuing to appear on statements for the $1.2 million investment account that had been awarded to wife. Husband and wife presented statements showing that wife's name was on the account by October 2011. While there was a factual dispute relating to this last badge of fraud, the Court held that summary judgment was proper because a number of other badges of fraud were established which gave rise to an inference of fraud that husband and wife had failed to rebut.

Although the facts pointing to fraud seemed fairly clear in Citizens State Bank, it is not difficult to imagine a scenario where divorcing spouses who innocently stipulate to entry of a decree inadvertently find themselves on the receiving end of a MUFTA claim brought by a desperate creditor looking to cast a wide net. Consider the example posited by the Justice Anderson in his concurring opinion of a business owner who is struggling financially but stipulates to a decree which is more favorable to his wife because he believes the business will recover and he intends to repay his creditors when that happens. Citizens State Bank provides some guidance for advising dissolution clients facing potential MUFTA issues.

First, the reality is that some of the badges of fraud may simply be inescapable. For example, your client probably will have little to no control over whether "before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit." But to the extent that your client anticipates what may be coming, it would be better to have the divorce entered sooner rather than later.

Be mindful of how property is titled and what transfers will be required to implement the division of property. Typically, this is not something we pay much attention to because a marital asset titled in one spouse's name is nonetheless a marital asset. But title is important in evaluating whether "the transfer was of substantially all the debtor's assets" because that analysis focuses on transfers of assets in the debtor's name and would not appear to include assets titled in the name of the debtor's spouse to which the debtor would have a right as part of the division of marital property.

Similarly, pay attention to what property is exempt. This is not a typical consideration in sizing up a potential settlement on a balance sheet but it is hugely important in evaluating whether someone has transferred substantially all of their assets, whether they have received reasonably equivalent value for the assets they transferred, and whether someone was insolvent or became insolvent after the transfer. An equal division of property will appear disproportionate under MUFTA if one of the parties happens to be receiving all of the exempt assets.

If the division of property is disproportionate, include detailed findings explaining why that is the case. For example, if property is being used to buy out or buy down a spousal maintenance claim or satisfy a contribution to a dependent spouse's attorneys' fees, make sure that is reflected in the findings. Detailed findings will help establish that the debtor spouse received reasonably equivalent value for the assets transferred.

Where parties are cooperating, they may not feel a sense of urgency to take care of transferring title to assets in order to implement the division of property. But for assets awarded to the non-debtor spouse that are jointly titled or titled in the name of the debtor spouse, make sure that the parties do so right away to avoid creating the appearance that the debtor has retained possession or control of the asset.

Although there may be practical reasons to live together after the divorce, where a potential MUFTA claim is a real concern, remind clients that doing so will likely make them insiders. Living with friends or relatives is not ideal but it is one of the badges of fraud over which the parties have an ability to control.

Finally, remember that there are many reasons which would justify dividing assets disproportionately that do not fall within the parameters of the badges of fraud. For example, a spouse's poor health or one party's depletion of assets during the marriage are considerations recognized in the family law context that escape analysis under MUFTA. Evidence of these reasons for the division of assets in the decree may be used to rebut an inference of fraud if one is created by the presence of several badges of fraud (which is another reason for including detailed findings explaining the division of assets).

While MUFTA is not likely to be a routine part of most dissolution practices, it is important to evaluate potential consequences when working on cases where one of the parties has a major creditor.

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