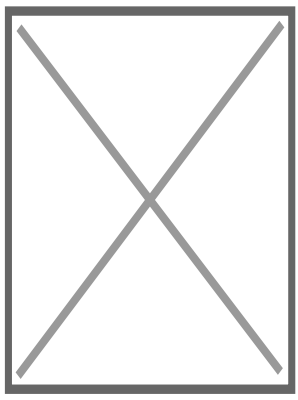
BUSINESS OWNERS BEWARE: DEFENSES TO THE BIG BAD BANKRUPTCY TRUSTEE'S SUIT AGAINST YOUR BUSINESS FOR FRAUDULENT TRANSFERS (PART II)

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Your business now faces an adversary complaint filed by the bankruptcy trustee. The complaint has several counts alleging that your business received fraudulent transfers of assets from a debtor in bankruptcy. The complaint alleges two types of fraudulent transfers. The first is actual fraud, which involves a debtor's intent to delay, hinder, or defraud its creditors. The second is referred to as constructive fraud, which involves a debtor's transfer of assets made in exchange for inadequate consideration.

Type of Transferee

Your business may have defenses available to a claim of either actual or constructive fraud. The first step in analyzing what defenses are available is to determine what type of transferee you are. An "initial transferee" is one who receives the fraudulently-transferred funds directly from the debtor. If your business is the "initial transferee," then as the recipient of the transfer, your business bears the burden of proving that it gave value to the debtor and received the property in good faith. If your business did not receive the transfer directly from the debtor, then the business would be a "mediate" or "subsequent" transferee, and in this instance, your business bears the burden of proving that it received the property in good faith. Determining what type of transferee your business is determines what it must prove to defeat a trustee's claim – good faith and value if an initial transferee, or just good faith for a mediate or subsequent transferee.

Good Faith

In either instance, your business will have to prove that it received the transfer in good faith. Good faith is judged using an objective standard, where a court will look to what your business objectively "knew or should

have known" rather than examining what it actually knew from a subjective standpoint. If the circumstances would place a reasonable person or entity on inquiry of a debtor's fraudulent purpose, and diligent inquiry would have discovered the fraudulent purpose, then the transferee may be found to have not acted in good faith.

Value

If your business was the initial transferee, then it will have to prove that it also provided value to the debtor in exchange for the transfer. The Bankruptcy Code and Florida Statutes provide that 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. In determining whether a debtor received reasonably equivalent value, the essential examination is a comparison of "what went out" with "what was received."

Mere Conduit

There is case law in the Eleventh Circuit that has developed around the meaning of "initial transferee." In examining what "initial transferee" means, courts have developed an exception known as the mere conduit or control test. This exception is asserted as an affirmative defense where an initial recipient of a transfer, usually a bank or escrow agent, actually received the transfer but is legally not an "initial transferee" because that party has no control over the fraudulently-transferred funds. Under the Eleventh Circuit precedent, to satisfy the mere conduit test, a party would need to lack control over the funds, i.e., that the party merely served as a conduit for the assets that were under the actual control of the debtor-transferor.

Conclusion

If your business is facing a demand made by a bankruptcy trustee or has been served with a complaint seeking to avoid transfers as fraudulent, it is important to understand any possible defenses that are available. Knowing your rights under the Bankruptcy Code is key to protecting your property. Attorneys at Berger Singerman, LLP regularly represent bankruptcy trustees and transferees in avoidance actions throughout the State of Florida and can help you or your business navigate this complex area.

For more information, please contact the author, Ashley Dillman Bruce on our Business Reorganization Team.

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