





## WHAT IS IT?

# Bankruptcy Litigation: Fraudulent Transfers

## Summary

Fraudulent transfer actions seek to “avoid” or “unwind” certain pre-bankruptcy transactions so that the value of such transactions can be recovered and redistributed to the debtor’s creditors.

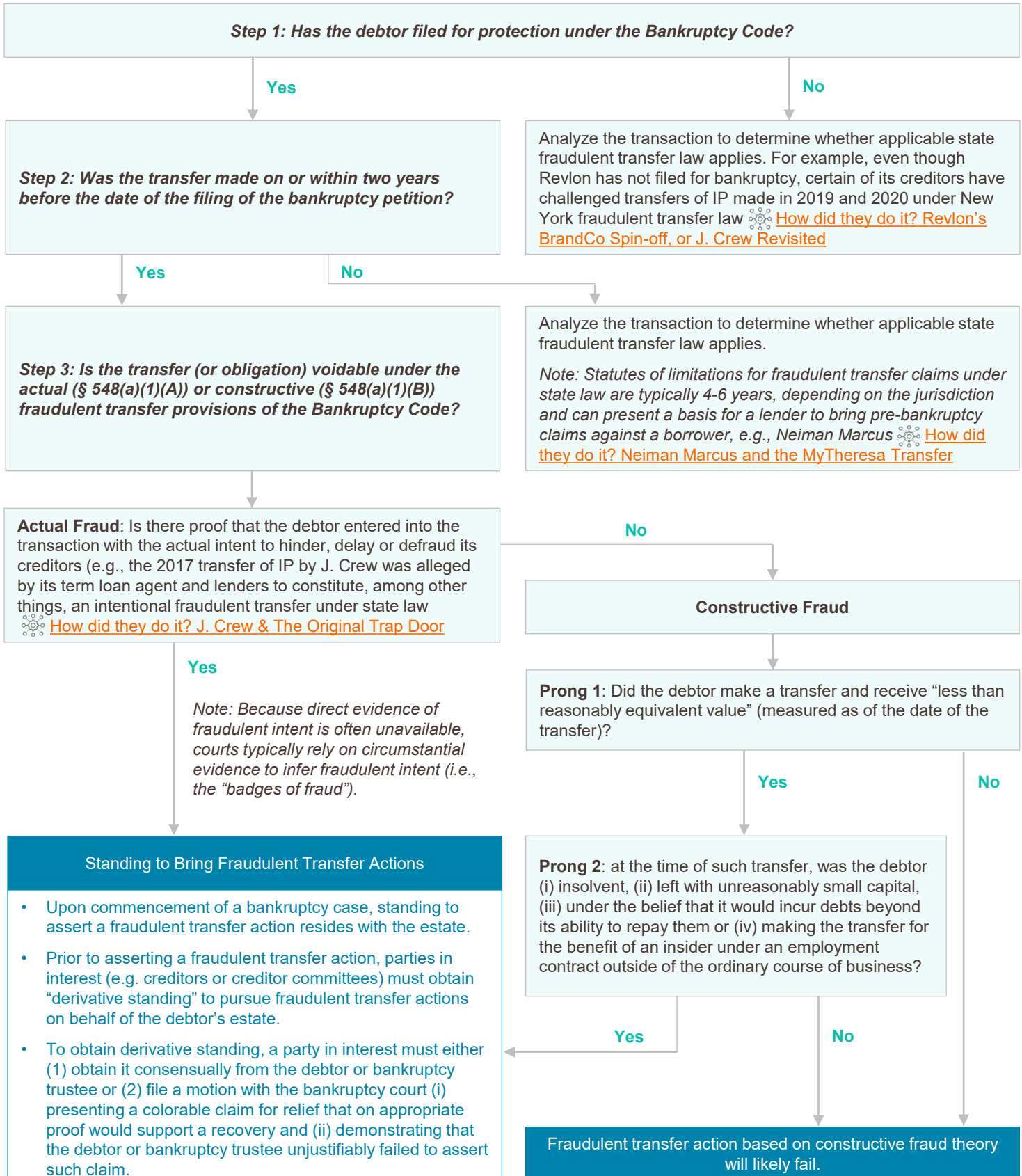
Under title 11 of the United States Code (as amended, the “Bankruptcy Code”), a “fraudulent transfer” occurs when a debtor either (1) transfers property with the intent to hinder, delay or defraud its creditors or (2) makes a transfer for less than reasonably equivalent value and at the time of such transfer: (i) was insolvent; (ii) had unreasonably small capital; (iii) intended to incur debts beyond its ability to repay them or (iv) made such transfer for the benefit of an insider under an employment contract outside of the ordinary course of business. 11 U.S.C. § 548(a)(1)(A)-(B).

As Sponsors continue  to pursue liability management transactions in the face of ongoing portfolio company distress, the ability to challenge such transactions in a Borrower’s chapter 11 proceeding can be a potent tool in the hands of the bankruptcy estate or parties entitled to sue on its behalf. Furthermore, even where a given  set of loan documents may have contractually permitted the subject transaction, the ability to bring colorable fraudulent transfer claims can serve to spur meaningful settlement discussions with the Sponsor in connection with the Chapter 11 plan process.

***While the facts of each case will differ, the following flow-chart is intended to guide lenders and borrowers through the decision-making process as to whether and when a potential fraudulent transfer may be asserted.***

# Bankruptcy Litigation: Fraudulent Transfers (cont'd)

## Asserting Fraudulent Transfer Actions



## Bankruptcy Litigation: Fraudulent Transfers (cont'd)

### Defenses to Fraudulent Transfer Claims

- Does the transfer satisfy all of the above requirements (i.e. was it made within two years of bankruptcy (i) with the intent to hinder, delay or defraud creditors or (ii) for less than reasonably equivalent value while the debtor was insolvent or on the verge of insolvency)?
  - If NO, then the transferee may assert that the plaintiff failed to satisfy the necessary elements of its fraudulent transfer claim.
- Was the transfer made *by, to or for the benefit* of a commodity broker, forward contract merchant, financial institution, financial participant or securities clearing agency? 11 U.S.C. § 546(e).
  - *Note: the safe harbor under Bankruptcy Code Section 546(e) protects transfers made by or to – not through – one of the protected entities listed above. Merit Management Group, LP v. FTI Consulting, Inc., 138 S.Ct. 883 (2018)*
  - If YES, then the transferee may assert the 546(e) safe harbor as a defense.
- Did the transferee act in good faith? 11 U.S.C. § 550(b)(1).
  - Did the transferee take for value, in good faith, and without knowledge of the voidability of the transfer?
  - IF YES, then the transferee may assert a good-faith defense under Section 550(b) of the Bankruptcy Code.