

## What Could Go Wrong?

**Quick-Take:** ‘Timing is everything’ when it comes to dealing with a voidable transaction, such as transferring assets *after* a claim to a family member or to a self-settled asset protection trust.

**Background:** Michigan is one of the states that permits an individual to transfer assets to an irrevocable non-grantor trust and still be a potential beneficiary of the trust that he /she creates. The Michigan Qualified Dispositions in Trust Act is Michigan’s version of a self-settled domestic asset protection trust, or DAPT. [MCL 700.1041 et seq.] Yet the use of a DAPT is unlikely to protect future claims if the DAPT is not funded until *after* a creditor claim arises against the settlor. A transfer of assets to a family member or a DAPT *after* a claim arises can be a voidable transfer under Michigan’s version of the Uniform Voidable Transaction Act. [MCL 566.31 et seq.]

**Claims:** To state the obvious, a claim is an event that gives rise to liability. The liability arises immediately when a bad thing happens that eventually ultimately turns into a judgment. Once a claim arises, the voidable transaction laws kick-in and any subsequent transfers by the debtor can be challenged by his/her creditors. If a claim arises, it does not matter if no demand letter has been received, that no lawsuit has been filed, or that there is no judgment (yet) entered against the debtor. None of these ‘litigation’ ‘events’ really matter. That they have not yet occurred does not provide a defense to a claim that asserts that a voidable transaction occurred.

**Personal Guarantees:** A personal guarantee is the least understood aspect of the fraudulent transaction law. When a personal guarantee is signed, at that moment in time, the liability is incurred for the payment of the entire debt- all of the debt. The claim arises the moment the personal guarantee is signed. It does not matter if there has not been a default on the debt, or even if payments on the debt are still current. The liability for the entire outstanding debt is still based on the personal guarantee. Accordingly, for real estate investors, this means that they are insolvent on a balance-sheet ‘test’ the moment that the investor signs the personal guarantee, all of which means that any transfers made by the investor after a guarantee is signed could be subject to the voidable transaction laws.

**Timing: Bright-line ‘Test:’** The key point is that any transfers made to a DAPT, or to anyone, *before* a claim arises are permissible transfers, removed from voidable transactions exposure assuming the debtor was solvent when the transfer was made. In contrast, any transfers made *after* a claim arises could be impermissible under the lens of the voidable transaction laws. If a transfer is impermissible, meaning that the voidable transaction laws have been violated with the transfer by an individual, that individual’s situation can go from bad to much worse. ‘How much worse’ you ask?

**What Could Go Wrong?** Some possible consequences of a debtor making a voidable transfer might include the following:

**Transferee Exposure:** A voidable transaction suit is not against the debtor but primarily against the transferee of the debtor’s property. Such a lawsuit forces the transferee to either return the property (so the judgment creditor can then levy on it) or pay a money judgment equal to the value of the property that was transferred. Thus, the transferee is the target of the judgment creditors. If the transfer was made to a family member, e.g., a parent, then the family member will be embroiled in the collection litigation, paying their own legal fees, which inevitably will put additional pressure on the debtor to ‘pay-up.’

**Attorneys’ Fees Exposure:** If attorneys’ fees were awarded in the underlying claim action, attorneys’ fees can be awarded to ‘unwind’ the debtor’s voidable transaction. Accordingly, the award of these attorneys’ fees, when added to the underlying financial judgment on the claim, will make the debtor’s situation even worse. Some states can make this award of attorney’s fees on the ‘unwinding’ transaction litigation joint between the debtor and his/her transferee (who may have much ‘deeper pockets’ than the debtor.)

**Civil Conspiracy Exposure:** If an award of attorneys’ fees is not available to the judgment creditor, that creditor might still attempt to recover those legal fees as damages arising from a civil conspiracy (which is an agreement between two persons either to accomplish a legal objective by wrongful means, or a wrongful objective by legal means.) In addition, a judgment creditor’s civil conspiracy claim can extend beyond the parties to the challenged transaction to include anyone who planned or assisted with the debtor’s transfer, including bankers, financial planners, accountants, and attorneys.

**Exemplary Damages Exposure:** Some states permit exemplary damages to be awarded if the voidable transaction is egregious, meaning that the transfer was clearly intended to avoid the enforcement of a judgment. [MCL 600.2919a, for embezzling or conversion, or to ‘deter fraud.’) These damages can be awarded up to three times the value of the property that was transferred. Creative judgment creditors have also been successful in asserting civil RICO claims against transferors and their transferees when there has been a voidable transaction.. Add to this punitive damages exposure the fact that these damages are not usually dischargeable in bankruptcy.

**Bankruptcy Exposure:** If the voidable transfer is made within one year immediately before the debtor files for bankruptcy, the Bankruptcy Court could deny the debtor a discharge of his/her debt that often forced them to file for bankruptcy protection. [U.S. Bankruptcy Code, Section 727.]

**Attorney Privileged Communications Exposure:** If a judgment creditor can make a prima facie case that a voidable transaction occurred, the trial court could vitiate the attorney-client privilege and expose all communications between the debtor and his/her attorney regarding the challenged transaction. This exposure could lead to the judgment creditor learning about the debtor’s other assets that might not have been otherwise disclosed improving the creditor’s chances of satisfying his/her judgment..

**Conclusion:** Severe, if not devastating, consequences can arise from a voidable transaction, not only to the debtor but also to the transferee, along with the debtor’s advisors. The old adage ‘there’s no harm in trying’ does not apply when it comes to making a transfer of property after a claim arises. Just the opposite, a lot more could go wrong if a transfer of property is made in violation of the Uniform Voidable Transaction Act.

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