



## Pleading Fraudulent Conveyances: Federal vs. New York State Requirements

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### Introduction

Fraudulent conveyances are transfers of a debtor's property made to defraud, burden, and unfairly place the property out of reach of the creditor.<sup>1</sup> Such transfers are illegal and therefore prohibited under both federal and New York State law.<sup>2</sup> Federal fraudulent conveyance law, the United States Bankruptcy Code (the "Bankruptcy Code"), recognizes two different types of fraudulent conveyances: intentional ("actual") fraudulent transfers and constructive fraudulent transfers.<sup>3</sup> Each of these fraudulent transfers require different pleading standards. These two types of fraud are recognized in New York, as well.<sup>4</sup> If these fraudulent conveyances can be proven, both federal and state law allow for trustees to avoid these transfers.<sup>5</sup>

Both similarities and differences exist between fraudulent transfer pleading standards under federal law and New York State law. New York recently adopted a new fraudulent conveyance

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<sup>1</sup> See 11 U.S.C. § 548(a)(1)(A).

<sup>2</sup> *Id.*

<sup>3</sup> See 11 U.S.C. § 548(a)(b).

<sup>4</sup> See N.Y. DCL §§ 273-276.

<sup>5</sup> See generally 11 U.S.C. § 544; see also N.Y. DCL §§ 273-276.

statute, the Uniform Voidable Transactions Act (the “UVTA”). The UVTA became effective in April 2020 and is consistent with much of the Bankruptcy Code.<sup>6</sup>

This memorandum compares the fraudulent conveyance statutes and pleading requirements under federal law to the standards imposed under New York State law. Part I of this memorandum first discusses the general pleading standards when filing a complaint in federal court. It also identifies and defines the two types of fraudulent conveyances prohibited under the Bankruptcy Code -- intentional fraudulent conveyances and constructive fraudulent conveyances -- and addresses the different pleading standards for each type of fraud.

Part II of this memorandum addresses the pleading requirements for complaints filed in New York State, and then compares the pleading standards under New York’s old statute, the Uniform Fraudulent Conveyance Act (the “UFCA”), to its new statute, the UVTA.

## **I. Pleading Fraudulent Conveyances under the Bankruptcy Code**

### **A. An Overview of Federal Pleading Standards**

Commencing a bankruptcy proceeding to claim fraud requires the filing of a complaint. A complaint must sufficiently allege “enough facts to state a claim to relief that is plausible on its face.”<sup>7</sup> Claims are plausible when the factual claims allow courts to “draw the reasonable inference that the defendant is liable for the misconduct alleged.”<sup>8</sup> Meeting the plausibility standard requires a complaint to plead facts that show “more than a sheer possibility” that a defendant’s acts were illicit.<sup>9</sup> Complaints merely reciting elements of causes of action and conclusory statements are insufficient.<sup>10</sup> The complaint must prove that a plaintiff’s right to relief is more than simply speculative.<sup>11</sup>

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<sup>6</sup> See Thomas R. Slome, Michelle McMahon & Sophia Hepheastou, *Uniform Voidable Transaction Act Signed Into Law*, NEW YORK LAW JOURNAL (Dec. 9, 2019).

<sup>7</sup> *Bell Atl. Corp v. Twombly*, 550 U.S. 544, 547, (2007).

<sup>8</sup> FED. R. CIV. P. 12(b)(6).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> See *Spool v. World Child Intern. Adoption Agency*, 529 F.3d 178, 183 (2d. Cir. 2008).

Federal Rule of Civil Procedure 12(b)(6) governs when pleadings fail to state a claim upon which relief can be granted; if no such claim is made, the complaint will be dismissed.<sup>12</sup> Federal Rule of Civil Procedure 12(b)(6) is made applicable in bankruptcy pleadings, specifically, through Federal Rule of Bankruptcy Procedure 7012(b).<sup>13</sup>

The pleading standards for intentional and constructive fraudulent transfers under the Bankruptcy Code are distinct and governed by different rules. Intentional fraudulent transfers are subject to a stringent “particularity” standard, under Federal Rule of Civil Procedure 9(b), whereas constructive fraudulent transfers are subject to the more lenient “fair notice” standard under the Federal Rule of Civil Procedure 8(a).<sup>14</sup>

#### B. Pleading Intentional Fraudulent Transfers

Intentional fraudulent conveyances are prohibited transfers that are made with the intent to hinder, delay, or defraud any creditor.<sup>15</sup> In order to determine whether an act qualifies as an intentional fraudulent conveyance, courts need to prove that a creditor was *purposefully* defrauded. When determining whether an act qualifies as an intentional fraud, courts will look at the intent of corporate agents and individuals in cases where the debtor is not an individual.<sup>16</sup>

The difficulty in proving one’s mental state can make it challenging to actually prove the objectives behind one’s actions.<sup>17</sup> Thus, circumstantial evidence can be used to prove intentional fraud and help support one’s case.<sup>18</sup> Such circumstantial evidence is known as “badges of fraud” and can be relied on when pleading intentional fraud.<sup>19</sup> “Badges of fraud” are defined as

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<sup>12</sup> See FED. R. CIV. P. 12(b)(6).

<sup>13</sup> FED. R. CIV. P. 7012(b).

<sup>14</sup> See FED. R. CIV. P. 9b; *see also* FED. R. CIV. P. 8(a).

<sup>15</sup> See 11 U.S.C. § 548(a)(1)(A).

<sup>16</sup> See *Kirschner v. Fitzsimons (In re Tribune Co. Fraudulent Conveyance Litig.)*, 2017 WL 82391 at \*5 (S.D.N.Y. Jan 6, 2017).

<sup>17</sup> See *Sharp Int’l Corp v. State St. Bank & Tr. Co. (In re Sharp Int’l Corp)*, 403 F.3d 43, 56 (2d Cir. 2005).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

“circumstances so commonly associated with fraudulent transfers that their presence gives rise to an inference of intent.”<sup>20</sup> Different examples of badges of fraud include:

(1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit, or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence of cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency of threat of suits by creditors; (6) the general chronology of the events and transactions under inquiry; (7) a questionable transfer not in the usual course of business; and (8) the secrecy, haste, or unusualness of the transaction.<sup>21</sup>

In *In re Tronox*, the complaint stated multiple badges of fraud.<sup>22</sup> The complaint alleged that the transfers were made for the benefit of an insider, that such insider took steps to conceal potential liabilities, and that plaintiff, Tronox, was left insolvent as a result.<sup>23</sup> While many courts allow parties to rely on badges of fraud, such reliance is not a mandatory.<sup>24</sup>

The strict “particularity” standard required when pleading intentional fraud mandates that a plaintiff, “state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally.”<sup>25</sup> The Second Circuit has held that complaints alleging intentional fraud must: “(1) detail the statements (or omissions) that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements (or omissions) were made, and (4) explain why the statements (or omissions) were fraudulent.” Although Federal Rule of Civil Procedure 9(b) permits general statements when alleging one’s mental state, pleaders still must state facts that give rise to a “strong inference of fraudulent intent.”<sup>26</sup> Such inferences can be proven either by stating facts that show defendants possessed both the motive and opportunity to commit fraud, or by asserting

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<sup>20</sup> *Id.*

<sup>21</sup> *Silverman v. Actrade Capital, Inc. (In re Actrade Fin. Techs., Ltd.)*, 337 B.R. 791, 809 (Bankr.S.D.N.Y. 2005).

<sup>22</sup> *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 429 B.R. 73, 96 (Bankr. S.D.N.Y. 2010).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> FED. R. CIV. P. 9(b).

<sup>26</sup> *Shield v. Citytrust Bancorp Inc.*, 25 F.3d 1124, 1128 (2d. Cir. 1994).

facts establishing strong circumstantial evidence indicating deliberate misconduct or recklessness.<sup>27</sup>

### C. Pleading Constructive Fraudulent Transfers

The other type of fraudulent transfer prohibited under the Bankruptcy Code, constructive fraud, is shown by a trustee by proving “the presence of several conspicuous elements, rather than proving actual fraud itself.”<sup>28</sup>

Section 548(a)(1)(B) of the Bankruptcy Code provides that constructive fraud can be shown where the debtor:

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation; (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor’s ability to pay as such debts matured; or (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

Constructive fraud’s “fair notice” standard imposed under Federal Rule of Civil Procedure 8(a) is more lenient than intentional fraud’s “particularity” standard imposed under Federal Rule of Civil Procedure 9(b). Pleading constructive fraud requires that plaintiffs use a “short and plain statement of the claim showing that the pleader is entitled to relief.”<sup>29</sup> Plaintiffs must also demand the relief sought.<sup>30</sup> Alternative forms of relief may also be included in the complaint.<sup>31</sup>

Plaintiffs pleading constructive fraud must provide defendants with enough information that would allow defendants to have a fair understanding of what is being alleged.<sup>32</sup> For example, in *In re Tronox*, the complaint alleging constructive fraud was sufficiently plead, as the allegations

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<sup>27</sup> *Id.*

<sup>28</sup> *Bayou Accredited Fund, LLC v. Redwood Growth Partners, L.P. (In re Bayou Grp., LLC)* 396 B.R. 810, 827-28 (Bankr. S.D.N.Y. 2008).

<sup>29</sup> FED. R. CIV. P. 8(a)(1)(2).

<sup>30</sup> *Id.*

<sup>31</sup> FED. R. CIV. P. 8(a)(2).

<sup>32</sup> *In re Tronox Inc.*, 429 B.R. 73.

properly stated a claim.<sup>33</sup> The complaint alleged that assets were sold to the defendants shortly after the spin-off for \$16.4 billion and \$1.6 billion of assumed debt and the value of the cash transfer was \$785 million.<sup>34</sup> It specifically alleged that no consideration was provided to the plaintiffs for the assets that were transferred.<sup>35</sup> Additionally, the defendants’ imposed massive “legacy obligations” on the plaintiffs, together with the new debt incurred in the spin-off, leaving (the plaintiffs) insolvent and without adequate capital.<sup>36</sup> Thus, the complaint did not simply repeat elements of the statute, but it stated many supporting facts that identified the property transferred and obligations incurred.<sup>37</sup>

Pleading constructive fraud also requires the plaintiff to provide the defendant with “sufficient notice” to prepare an answer to the charges, organize discovery, and defend his or herself against the allegations.<sup>38</sup> Stating fraud with particularity is not required for pleading constructive fraud because such claims are not based in actual fraud.<sup>39</sup>

## **II. Fraudulent Conveyances Under New York State Law**

### **A. An Overview of New York State Pleading Standards**

Complaints filed in state court have their own set of pleading requirements. Standards for federally filed complaints are prescribed by the Federal Rules of Civil Procedure, while complaints filed in New York State are governed by the New York Civil Practice Law and Rules (the “CPLR”). New York CPLR dictates that specific actions must be plead with particularity.<sup>40</sup> “Statements in a pleading shall be sufficiently particular to give the court and parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and

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<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *See* N.Y. C.P.L.R. 3016.

the material elements of each cause of action or defense.”<sup>41</sup> It is also mandated that such statements should be succinct and plain.<sup>42</sup> When pleading fraud, the CPLR mandates, “where a cause of action or defense is based upon misrepresentation, fraud, mistake, willful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail.”<sup>43</sup>

Pleadings are afforded “liberal construction” and the court is to provide the claimant with “the benefit of every possible favorable inference.”<sup>44</sup> However, “bare legal conclusions” do not suffice.<sup>45</sup> In order to survive a motion to dismiss, the complaint must state a cause of action.<sup>46</sup> For example, a pro se plaintiff filed a five-page hand-written complaint consisting of numbers not consecutively numbered, lacking any “coherent allegations of fact.” The lack of factual statements alleging any “cognizable claim in law or equity” led the complaint to be dismissed pursuant to N.Y. C.P.L.R. 3211(a)(7). When defendants seek dismissal, the court must conclude whether or not the plaintiff *actually* has a valid cause of action; the court cannot simply determine if one has been stated on the complaint.<sup>47</sup>

B. New York’s Former Law: The Uniform Fraudulent Conveyance Act vs. The Bankruptcy Code

New York State’s fraudulent conveyance statute was previously governed by the Uniform Fraudulent Conveyance Act (the “UFCA”) in Article 10 §§270-281 of the New York Debtor and Creditor Law (“N.Y. DCL”). The UFCA, just like the Bankruptcy Code, recognizes both actual and constructive fraudulent conveyances, allowing for their recovery.<sup>48</sup> The UFCA recognizes

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<sup>41</sup> N.Y. C.P.L.R. 3013.

<sup>42</sup> See N.Y. C.P.L.R. 3014.

<sup>43</sup> N.Y. C.P.L.R. 3016(b).

<sup>44</sup> *Matter of Sud*, 211 A.D.2d at 424.

<sup>45</sup> *Id.*

<sup>46</sup> N.Y. C.P.L.R. 3211(a)(7).

<sup>47</sup> See *Asgahar v. Tringali Realty, Inc.*, 18 A.D.3d 408, 409 (2d. Dept. 2005).

<sup>48</sup> See NY DCL §§ 273-276.

actual fraudulent conveyances and states, “every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.”<sup>49</sup> If the intent cannot be proven, constructive fraudulent conveyances are recognized under N.Y. DCL.<sup>50</sup>

The pleading standards for fraudulent transfers under the UFCA are similar to those of the Bankruptcy Code. Parties asserting intentional fraudulent transfers under either the UFCA or the Bankruptcy Code must usually declare (1) property subject to the transfer, (2) the timing (and the frequency of the transfer, if it proves to be applicable), and (3) the consideration paid.<sup>51</sup> Plaintiffs pleading a claim for an actual fraudulent conveyance under the UFCA must state that “(1) the thing transferred has value of which the creditor could have realized a portion of its claim; (2) that this thing was transferred or disposed of by the debtor and (3) that the transfer was done with actual intent to defraud.”<sup>52</sup>

In pleading constructive fraud, both the UFCA and federal law dictate that plaintiffs show the debtor was insolvent, undercapitalized, or that he or she believes the debts he or she incurs would surpass his or her ability to pay.<sup>53</sup> However, the UFCA does slightly differ from the Bankruptcy Code in its constructive fraudulent transfer pleading requirements.<sup>54</sup> Unlike the Bankruptcy Code, which mandates that any transfer made with a “lack of reasonably equivalent value” is fraudulent, the UFCA deems that any transfer made without “fair consideration” is fraudulent.<sup>55</sup> Thus, under the UFCA, the trustee can plead a “lack of fair equivalent value *or* a lack of good

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<sup>49</sup> *Id.*

<sup>50</sup> See N.Y. DCL §§ 273-275.

<sup>51</sup> *Official Comm. Of Unsecured Creditors v. JP Morgan Chase Bank, N.A. (In re M. Fabrikant & Sons, Inc.)*, 394 B.R. 721, 733-735 (Bankr. S.D.N.Y. 2008).

<sup>52</sup> *Chambers v. Weinstein*, 44 Misc.3d 1223(A) at \*7 (Sup. Ct. N.Y. County 2014).

<sup>53</sup> *Id.*

<sup>54</sup> See N.Y. DCL §§ 272(a), 273, 274.

<sup>55</sup> *Id.*

faith on part of the transferee.”<sup>56</sup> The UFCA analyzes not only the transfer’s substantive value, but the decision-making process that goes into the transfer, as well.<sup>57</sup>

C. New York’s New, Current Law: The Uniform Voidable Transactions Act and How it Differs from The Uniform Fraudulent Conveyance Act

In New York, the Uniform Voidable Transactions Act (“UVTA”) replaced the UFCA in Article 10 §§ 270-281 of the N.Y. DCL on April 4, 2020.<sup>58</sup> Over 40 states in the United States, including California, have already adopted the UVTA.<sup>59</sup> The UVTA’s provisions are very similar to those of the Bankruptcy Code.<sup>60</sup>

The purpose of the UVTA is to prevent debtors from placing property that should be available to satisfy a debt out of a creditor’s reach.<sup>61</sup> Just like the UFCA, the UVTA recognizes both actual and constructive fraudulent conveyances and allows for their recovery.<sup>62</sup>

The UVTA differs from both the UFCA and the Bankruptcy Code because it eliminates the existence of a stringent pleading standard for both types of fraudulent conveyances.<sup>63</sup> Under the UVTA, there is no requirement to plead claims with “particularity” as required by FRCP 9(b), or to plead with detail as required by N.Y. C.P.L.R. 3016(b).<sup>64</sup> The heightened pleading requirement prescribed by FRCP 9(b) has previously led to confusion amongst courts regarding

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<sup>56</sup> *Id.*

<sup>57</sup> See *45 John Lofts, LLC v. Meridian Capital Grp. LLC (In re 45 John Lofts, LLC)*, Case No. 17-01179, 599 B.R. 730 (Bankr. S.D.N.Y. Apr. 19, 2019).

<sup>58</sup> See Thomas R. Slome, Michelle McMahon & Sophia Hepheastou, *Uniform Voidable Transaction Act Signed Into Law*, NEW YORK LAW JOURNAL (Dec. 9, 2019).

<sup>59</sup> See *id.*

<sup>60</sup> See *id.*

<sup>61</sup> See Cal. Civ. Code § 3439; see also *Chen v. Berenjian*, 33 Cal. App. 5th 811, 815, 245 Cal. Rptr. 3d 378, 381 (Ct. App. 2019).

<sup>62</sup> See Cal. Civ. Code § 3409.04(a)(1)(2); see also *Lo v. Lee*, 24 Cal. App. 5th 1065, 1071, 234 Cal. Rptr. 3d 824, 827 (Ct. App. 2018).

<sup>63</sup> See Cal. Civ. Code § 3439(4); see also Brian Yeretian, Guidance on the Uniform Voidable Transactions Act, Los Angeles Lawyer, Aug. 2015, at 13.

<sup>64</sup> See See FED. R. CIV. P. 9b; see also N.Y. C.P.L.R. 3016(b).

fraudulent transfer claims.<sup>65</sup> However, fraudulent transfer claims are *not* common law fraud claims, and thus are *not* required to meet heightened pleading standards.<sup>66</sup>

The adoption of the UVTA changes the relevance of the transferee's intent with regard to constructive fraudulent transfers. Proving intent was relevant under the UFCA.<sup>67</sup> Under the UFCA, any conveyance made *without* fair consideration is deemed fraudulent and pleading a lack of good faith on the transferee's part constituted a transfer made without "fair consideration."<sup>68</sup> Under the UVTA, a transferee's intent is immaterial when pleading constructive fraud.<sup>69</sup> Instead, the "reasonably equivalent value" requirement, where an insolvent debtor incurs an obligation for less than reasonably equivalent value, of the Bankruptcy Code is adopted.<sup>70</sup>

Another difference between the UFCA and UVTA is the standard of proof required for claims of and defenses against fraudulent transfers. Previously, under the UFCA, the burden of proof for pleading fraud was "clear and convincing evidence."<sup>71</sup> This "clear and convincing" standard also applies to common law fraud.<sup>72</sup> The UVTA uses a lower standard and mandates that creditors must prove the elements of a claim for relief by "preponderance of the evidence."<sup>73</sup> The defendant bears the same burden for establishing any defenses.<sup>74</sup> This "preponderance of the evidence" standard is in place for both constructive and actual fraudulent conveyances.<sup>75</sup>

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<sup>65</sup> See *Kranz v. Koenig*, 240 F.R.D. 453, 455 (D. Minn. 2007); see also *China Res. Prod. (U.S.A.) Ltd. v. Fayda Int'l. Inc.*, 788 F. Supp. 815, 819 (D. Del 1992); see also Brian Yeretizian, Guidance on the Uniform Voidable Transactions Act, Los Angeles Lawyer, Aug. 2015, at 13.

<sup>66</sup> See Cal. Civ. Code §3439(4); see also Brian Yeretizian, Guidance on the Uniform Voidable Transactions Act, Los Angeles Lawyer, Aug. 2015, at 13.

<sup>67</sup> See *Gowan v. Patriot Grp., LLC (In re Dreier LLP)*, 452 B.R. 391, 443 (Bankr. S.D.N.Y. 2011).

<sup>68</sup> *Id.*

<sup>69</sup> *Lee*, 24 Cal. App. 5th 1065, 1072, 234 Cal. Rptr. 3d 824, 828.

<sup>70</sup> *Id.*

<sup>71</sup> See *Alice D. v. William M.*, 113 Misc.2d 940, 450 N.Y.S.2d 350, 354 (NY. City. Civ. Ct. 1982).

<sup>72</sup> *Id.*

<sup>73</sup> See *In re Hoch*, No. 16-03678-5-JNC, 2018 WL 583110, at \*7 (Bankr. E.D.N.C. 2018).

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

## Conclusion

Both federal and New York State law have their own respective fraudulent conveyance statutes. The Bankruptcy Code governs federal cases concerning fraudulent conveyances, while the Uniform Voidable Transactions Act now governs New York State fraudulent conveyance cases. Both statutes prohibit fraudulent transfers and allow for their recovery if proven.

Until April 4, 2020, New York was previously governed by the Uniform Fraudulent Conveyance Act. While there are many similarities between the Bankruptcy Code and the Uniform Fraudulent Conveyance Act, there are some existing differences, as well. Notably, under the UFCA, any transfer made without “fair consideration” is recognized as a constructive fraudulent conveyance.<sup>76</sup> Both federal and New York State law have their own specific pleading requirements in place when filing a fraudulent complaint, as well. The Federal Rules of Civil Procedure govern fraudulent conveyances under the Bankruptcy Code, while the New York Civil Practice Law and Rules govern fraudulent transfers under the UFCA.

New York’s recent shift from the UFCA to the widely adopted Uniform Voidable Transactions Act eliminates stringent pleading standards, yields a lower burden of proof, and alters the materiality of intent in pleading constructive fraudulent conveyances. The UVTA, which largely mirrors the Bankruptcy Code, has already been adopted by the majority of other states; thus, New York’s transition to the UVTA will likely decrease choice of law litigation and curb discordant results in bankruptcy litigation.

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<sup>76</sup> See N.Y. DCL §§ 272(a), 273, 274.

