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Case Note: Fraudulent Transfers and Attorney Obligations in Bankruptcy

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I. Introduction

In *In re GRAND JURY PROCEEDINGS, G.S. and F.S.*,[1] the United States Court of Appeals for the Eighth Circuit (Eighth Circuit or the court) applied the crime-fraud exception to the attorney-client work product privilege in the context of an alleged pre-bankruptcy fraudulent transfer.[2] The court's wide-ranging discussion of these issues highlights potential concerns for debtors and lawyers.[3] The *GRAND JURY* decision came roughly twenty-two years after the Eighth Circuit decided two other famous and controversial fraudulent transfer cases.[4] Together the material in these three high-profile case decisions from the Eighth Circuit highlights difficult legal and professional issues and seems an appopriate candidate for inclusion in law school case books.[5]

II. The *GRAND JURY* Decision

A. Introduction

In *GRAND JURY,* the government was seeking to compel a debtors' bankruptcy attorney ("J.P.", attorney J.P., or the attorney) to testify and produce documents in support of a grand jury investigation of his clients (the debtors, or "G.S." and "F.S.") for bankruptcy fraud, on grounds of alleged fraudulent transfers.[6] The attorney and the debtors argued that the attorney's testimony and documents were protected by the attorney-client privilege and the attorney work product privilege (the privileges). The district court rejected this defense, and the Eighth Circuit affirmed on grounds of the crime-fraud exception to the privileges.[7]

B. Facts of the Case

The facts are important, as they reflect on whether there was sufficient evidence of a fraudulent transfer as a matter of substantive law, as well as whether the attorney's involvement was sufficient to trigger the crime-fraud exception to the privileges. According to the facts as stated by the Eighth Circuit, the debtors were Iowa residents operating several businesses that began to experience financial problems in roughly 2001.[8] Later that year, they consulted attorney J.P., an experienced bankruptcy lawyer. Subsequently the debtors moved from Iowa to Florida, "a state which allows debtors to exempt more of their assets from the bankruptcy estate."[9]

Prior to meeting with J.P., the debtors had significant non-exempt assets that would be subject to the claims of creditors in a bankruptcy case, including "thousands of dollars worth of household furniture, jewelry, various stock holdings, and a contract from the sale of a business that entitled them to payments of approximately $300,000 over seven years."[10] The

1. 609 F.3d 909 (8th Cir. 2010).

2. *Id.*

3. *Id.* The *GRAND JURY* case has generated some discussion among lawyers, and was brought to your author's attention by Sam G. Bratton via the Oklahoma Bar Association's OBA Bankruptcy and Reorganization Section listserv operated through the office of Mary Craye. *See* owner-bankruptcy@okbar.org.

4. Hanson v. First National Bank in Brookings, 848 F.2d 866 (8th Cir. 1988); and Norwest Bank Nebraska v. Tveten, 848 F.2d 871 (8th Cir 1988). *See also* discussion *infra* at Part IV.

5. *Hanson* and *Tveten* have already achieved this honor. *See, e.g.*, WILLIAM D. WARREN & DANIEL J. BUSSEL, BANKRUPTCY 61 – 73 (8th ed. 2009).

6. *GRAND JURY*, 609 F.3d at 911.

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.* at 911-912.

debtors "sought J.P.'s advice in divesting themselves of these assets and converting the proceeds into assets that would be exempt from the bankruptcy estate."[11]

Here is where it gets interesting. The Eighth Circuit concluded (based on *in camera* evidence) that "J.P. warned his clients about avoiding bankruptcy fraud, counseling them concerning the dangers of engaging in insider transactions with close relatives and recovering assets post-bankruptcy."[12] This included, *e.g.,* advice against selling their furniture to a relative while retaining it in their home, or pledging stock as collateral for a loan from G.S.'s father. This advice seems commendable, and indeed goes beyond what the Eighth Circuit seemed to permit in its *Hanson* decision.[13] Yet, this seemingly sound and appropriate legal advice came back to haunt attorney J.P., when it was apparently cited in support of arguments that J.P. was aware of possible bankruptcy fraud by the debtors and therefore was subject to the crime-fraud exception to the attorney-client privilege.[14]

As noted by the court, "[n]otwithstanding this advice, G.S. and F.S. divested themselves of nearly all of their non-exempt assets by selling or loaning them to close family members. The furniture, jewelry, business contract and some of the stock holdings were sold to G.S.'s parents."[15] However, the Eighth Circuit's opinion does not provide any additional details about these subsequent transactions, *e.g.,* including important matters such as the terms of the transactions or the extent of any involvement by J.P.[16] Indeed, it appears that attorney J.P. was not involved in these transactions at all, except to the very limited extent noted below.

There was some detail as to one, separate other transaction, but that detail suggests that the transaction was relatively innocuous. In the separate transaction:

> The remaining stock was pledged to another relative, H.B., in exchange for a $52,000 loan. Because H.B. did not have money to make the loan, however, G.S.'s father gave her $52,000 to give to G.S., and attorney J.P. assisted with the transaction.[17]

This transaction, along with his advice to the debtors to avoid fraudulent pre-bankruptcy transactions, apparently was the primary evidence relied on in establishing the crime-fraud exception to the privileges.[18] However, there is no suggestion in the *GRAND JURY* opinion that the debtors received anything less than full value for the security interest granted to H.B., that the security interest placed the stock outside the bankruptcy estate, or that attorney J.P. assisted in any other pre-bankruptcy transaction by the debtors. Given the relevant facts, namely that: attorney J.P. warned the debtors against making fraudulent transfers; the transaction between the debtors and H.B. apparently involved a fair exchange of value;[19] there was no indication that attorney J.P. assisted with any of the other allegedly fraudulent transactions; and the source of a lender's funds for a secured transaction (*e.g.,* the secured loan from H.B. to the debtors) generally is not a factor of significance in such an analysis (despite some inference by the court to the contrary[20]), it seems that there was nothing inordinate about attorney J.P.'s involvement.

Nonetheless, after the Federal Bureau of Investigation began a bankruptcy fraud investigation against the debtors, the government sought to compel attorney J.P. to testify and produce attorney work product materials in support of the investigation, and the district court upheld the subpoena on grounds it fell within the crime-fraud exception to the privileges.[21]

C. The Eighth Circuit Analysis

1. Legal Issues and Standards

Although various issues relating to the substantive elements of fraudulent transfer law are illustrated in *GRAND JURY,* the narrow issue in the case was whether the attorney's work product and communications with his clients (the debtors) were protected by the privileges and therefore were not discoverable. The court began its analysis by noting that ordinarily the answer is yes, even in grand jury investigations.[22] However, there is a "crime-fraud exception," which excludes from such protection any communications or work product "made for the purpose of [providing] advice for the commission of a fraud or a crime."[23]

11. *Id.* at 912.

12. *Id.*

13. *See Hanson,* 848 F.2d 866, and discussion *infra* at IV.B. The advice against pledging stock seems particularly conservative, given that it would constitute a contemporaneous exchange of fair value and leave the transferred stock as property of the debtor and a subsequent bankruptcy estate. *See* the Bankruptcy Code, 11 U.S.C. § 541; *infra* notes 19, 43 & 87; and discussion *infra* at Part IV.B.

14. As suggested *supra* at note 13 and *infra* at note 19, this seems unfair in view of the transactions involved, and places bankruptcy attorneys in an untenable position. *See also* infra Part III. (noting dissent of Judge Bye).

15. *GRAND JURY,* 609 F.3d at 912.

16. *See id*. Obviously if the sales were at full market prices, or the loan proceeds were paid to the debtors, or attorney J.P. was not involved, these would be important considerations. *See infra* Parts II.C.5. & III.; *infra* notes 17-19.

17. *GRAND JURY,* 609 F.3d at 912. The proceeds from these transactions were paid to the debtors, who then (in separate transactions) used the money to purchase exempt life insurance policies. *Id*. A little over a year later the debtors filed bankruptcy in Florida. *Id.*

18. *Id*. Following completion of the Florida bankruptcy case, the debtors "returned to Iowa and recovered their original assets, repurchasing them for the prices at which the assets had been sold." *Id*. Once again, however (*see supra* this text and note 16), there is no indication in the Eighth Circuit opinion that these prices were inappropriate or that attorney J.P. was involved.

19. *See, e.g.*, 11 U.S.C. § 548(a)(1). Admittedly, a transfer for full value may nonetheless be fraudulent if made with intent to hinder, delay or defraud creditors (*see, e.g., id*. § 548(a)(1)(A)), and no doubt such an inquiry is part of the grand jury investigation giving rise to this case. But this "test" requires proof of intent, and is therefore relatively difficult to prove. Surrounding circumstances may be relevant, but this factor should be approached with caution, as it imposes a very difficult burden on a bankruptcy attorney making that determination in advance,
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19. *(Continued from previous column)*

as illustrated by this case. *See also* discussion *infra* at Part II.C.3.

20. *GRAND JURY*, 609 F.3d at 912.

21. *Id.*

22. *Id.*

23. *Id.* (*quoting*: *In re* Green Grand Jury Proceedings, 492 F.3d 976, 979 (8th Cir. 2007); and United States v. Zolin, 491 U.S. 554, 563, 109 S.Ct. 2619, 105 L.Ed.2d 469 (1985)). Given the broad scope of the quoted language, this is potentially a broad exception, suggesting the importance of the issues raised in this case. It also can be noted that the recent expansions in the scope of federal criminal law further broaden the reach of these
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The Eighth Circuit also noted a another consideration relevant to this issue, in the context of issues relating to a lawyer's work product, noting that (in addition to other relevant considerations) a lawyer has a separate interest in "protecting his [or her] opinions and thought processes from disclosure."[24] This obviously creates a unique set of issues that goes to the heart of the attorney-client relation and the ability of a lawyer to analyze issues and formulate legal strategies for the client.[25] Thus, the potentially broad scope of the crime-fraud exception collides to some extent with an extensive presumption of protection for an attorney's work product.

In an attempt to reconcile these considerations, the Eighth Circuit recognized the two categories of attorney work product: opinion work product and non-opinion work product.[26] Opinion work product includes the lawyer's opinions, conclusions, mental impressions, and legal theories, and is afforded "substantially more protection" than non-opinion work product.[27] Exactly how much more was the question in this case, because non-opinion work product is "generally discoverable 'upon a showing of substantial need and an inability to secure the substantial equivalent of the materials by alternate means without undue hardship.'"[28] Thus, one may expect that non-opinion attorney work product may be more or less routinely subject to discovery in fraudulent transfer cases, despite the likelihood of common expectations to the contrary, because of a perceived need for such material and the lack of an alternative source.

Moreover, even the attorney's opinion work product may be subject to such treatment, unless it meets certain tests in order to qualify for a sufficiently high level of protection.[29] One such test asks whether the lawyer is "complicit in his client's wrongdoing."[30] Only if there is no such complicity is the lawyer entitled to assert the privileges as to opinion work product.[31] Thus, if a lawyer's client has used the attorney's legal advice to commit a fraud or crime, production of the lawyer's opinion work product can be compelled unless the lawyer was unaware of the client's wrongful activities.[32] The legal risks of all of this, for clients and lawyers, *e.g.*, in the context of fraudulent transfer law, are obvious and dramatic (and perhaps counter-intuitive to those of us schooled in the traditions of the attorney-client privileges).

2. Arguments on Appeal

If any further demonstration of the above point is needed, the Eighth Circuit provided it in the *GRAND JURY* case.[33] The appellants (the debtors and their attorney, J.P.) argued that the district court abused its discretion in finding probable cause that the debtors sought J.P.'s advice in order to commit a fraud or crime.[34] In support they cited cases[35] holding that pre-bankruptcy asset-protection planning (including maximization of permitted exemptions and transfers to relatives) is not illegal *per se,* and that debtors are entitled to the benefits of "legislatively sanctioned exemption provisions."[36]

3. Legal and Evidentiary Standards

The *GRAND JURY* court, however, drew a finer line, stating that the test is "whether the debtor had fraudulent intent."[37] This is a difficult line to draw in practice, and required the court to look at a "variety of factors," which together encompass the law of fraudulent transfers and mark the difficult distinctions between legitimate pre-bankruptcy planning and behavior that triggers fraudulent transfer law (and, potentially, the crime-fraud exception to the privileges). Thus, "[g]iven the fact that direct evidence of fraud is rare, a court in most instances can only infer fraud by considering circumstantial evidence."[38]

While this is undoubtedly true, it is also unusually dangerous as a legal standard. Aside from the inherent ambiguities involved in distinguishing between essentially identical transactions based on an inference of fraudulent intent,[39] the idea of identifying and punishing a crime by reliance on "circumstances" supporting an "inference" is obviously dangerous. For this reason, the law has attempted to provide specific, meaningful, and limited standards to govern such determinations.[40] But courts still must exercise judgment in applying those

23. *(Continued from previous page)*

issues. *See, e.g.,* Gary Fields & John F. Emshwiller, *Federal Offenses, As Criminal Laws Proliferate, More Ensnared,* Wall Str. J., July 23–24, 2011, at A1 (noting that in recent years "the federal justice system has dramatically expanded its authority and reach.").

24. *GRAND JURY,* 609 F.3d at 912 (again quoting *Green,* 492 F.3d at 980).

25. *See generally GRAND JURY, id.*, at 916 (J. Bye, concurring in part and dissenting in part) ("Historically, a lawyer's mental impressions, conclusions, opinions, and legal theories have been afforded substantial protection in order to secure the lawyer's effective advocacy and representation of his or her client's interests."). *See also* discussion of Judge Bye's dissent, *infra* at Part III.

26. *GRAND JURY,* 609 F.3d at 913.

27. *Id.*

28. *Id.* (*quoting Green,* 492 F.3d at 980, *quoting In re Murphy,* 560 F.2d 326, 336 (8th Cir. 1977)).

29. *GRAND JURY*, 609 F.3d at 913.

30. *Id.*

31. *Id.*

32. *Id.*

33. As with the *Hanson* and *Tveten* cases, cited *supra* at note 4 and discussed *infra* at Part IV., the procedural posture of *GRAND JURY* is worthy of note. In all of these three cases the Eighth Circuit was reviewing a lower court decision based heavily on findings of fact, to determine whether there was reversible error. In this context, the deference due to the trier of fact on the issue of probable cause for application of the crime-fraud exception makes it inherently difficult for an appellate court to find an abuse of the trial court's discretion. *See, e.g., GRAND JURY,* 609 F.3d at 913.

34. *GRAND JURY*, 609 F.3d at 913.

35. *Id.* Including *In re* Addison, 540 F.3d 805 (8th Cir. 2008) (characterized in *GRAND JURY,* 609 F.3d at 913, as "reiterat[ing] the well-settled proposition that mere conversion of nonexempt assets into exempt assets pre-bankruptcy is not in itself

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fraudulent"); interestingly, *Hanson,* 848 F.2d 866, is not cited in the *GRAND JURY* opinion. *Cf.* discussion of *Hanson, infra* at Part IV.

36. *GRAND JURY,* 609 F.3d at 913. *See also infra* note 91 and accompanying text (separate opinion of Judge Bye in the *GRAND JURY* case).

37. *GRAND JURY*, 609 F.3d at 914.

38. *Id.* (*quoting In re* Sholdan, 217 F.3d 1006, 1009 (8th Cir. 2000)). *See also supra* note 19.

39. *See, e.g.*, discussion of *Hanson* and *Tveten, infra* at Part IV.

40. *See, e.g.*: Uniform Fradulent Conveyance Act (UFCA) §§ 4-7; Uniform Fradulent Transfer Act (UFTA) § 4; *infra* Part V.D.

standards. That is the hard part, and the results are not always beyond reproach.[41]

In *GRAND JURY,* the Eighth Circuit concluded that the district court did not abuse its discretion in finding probable cause of fraudulent intent: "The facts of fraudulent intent in this case include the debtors' transfer of virtually all of their non-exempt property—which consisted of a variety of different assets worth hundreds of thousands of dollars—to close relatives."[42] However, some of the specifics cited in support of this conclusion seem to cut the other way, illustrating the inherent difficulties in this kind of analysis.

For example, the court cited, as a particularly egregious example (because it "appeared to be specifically designed to conceal the true nature of the underlying transactions") the loan by a relative (H.B.) to the debtors of $52,000 borrowed by H.B. from the one debtor's father. The concern here is that the loan from H.B. was actually a loan from the father, in a sense "laundered" through H.B. Perhaps so, but the court's opinion indicates that this was a cash loan to the debtors secured by collateral, making it a contemporaneous exchange of value which did not diminish the value of assets available to satisfy creditors.[43] Of course, if the loan was part of a scheme for the debtors to use the loan proceeds to make a preferential or fraudulent transfer, the security interest received by the creditor may be subject to avoidance.[44] But this has little to do with the source of the lender's funds, and in any event transfers between family members are obviously common and not necessarily fraudulent. As long as they are fully disclosed, are for a full consideration, and otherwise do not diminish the debtor's assets, such transactions are not necessarily compelling (or sufficient) as evidence of fraud.

The other specific evidence cited by the court as indicating fraud was the post-bankruptcy recovery of the debtors' assets from their family members "for the same prices at which the assets had initially been sold."[45] This apparently occurred long after attorney J.P.'s involvement, and in any event can cut both ways, *e.g.,* it supports the view that the transfers were for fair market value.

4. Critique of the Court's Analysis

There are some obvious problems with the Eighth Circuit's line of reasoning. First, as suggested above, the court's emphasis on the lack of a disparity in the purchase and sales prices cuts against its conclusion, by indicating that the sales may have been arms-length transactions or at least for fair market value. The reacquisition at a higher price might, for example, indicate that the initial sale was for an inadequate consideration. And that should be a primary issue, namely: Did the debtors receive full value when they sold the assets?[46] If so, absent complicating factors, the debtors (and, ultimately, the debtors' bankruptcy estate) suffered no diminution of assets as a direct result of the transaction. In such a case, should it make any difference who the buyer was?[47] Or, in a credit transaction, where the lender got its funds? And, even if somehow relevant, is this compelling as a primary part of the evidence of fraud? Finally, it should be noted that, as it involves post-bankruptcy events, evidence that the debtors reacquired some assets likely was not known to attorney J.P. at the time of his pre-bankruptcy advice to the debtors,[48] and therefore seems irrelevant to the privileges at issue in the case.

The Eighth Circuit opinion similarly emphasizes other factors that seem to be of limited relevance to the privileges issue, *e.g.,* the debtors temporarily relocated to Florida before filing bankruptcy, and then later returned to Iowa.[49] It is noteworthy that the attorney in question (J.P.) ceased to represent the debtors prior to the bankruptcy and had no apparent connection to these later events (including the post-bankruptcy transfers).[50] After citing these examples as evidence, that as noted appears to be peripherally-related at best, the court summed up by concluding: "Taken together, these facts give rise to the inference that [the debtors] carried out a carefully planned scheme to divest themselves of all of their property through sham transactions…."[51] Your author generally approaches any totality of circumstances test with caution, as it may encourage an aggregation of minimally-relevant factors in an apparent hope that quantity can substitute for quality (which generally does not work well in legal analyses). This case may provide one such example.

This line of reasoning is particularly troublesome in the context of a legal standard based on inferences of wrongful intent. It is of course clear, and the law recognizes,[52] that direct proof of fraudulent intent is rare, and therefore inferences based on circumstantial evidence may be required.[53] But the limits and risks of this approach also should be recognized, lest this kind of standard become no standard at all, leading to inconsistent case decisions

41. *See, e.g.,* discussion of *Hanson* and *Tveton, infra* Part IV.

42. *GRAND JURY*, 609 F.3d at 914. *Cf.* discussion of *Hanson* and *Tveton, infra* at Part IV. *See, e.g., infra* this text at notes 126-144.

43. *See, e.g.*, the UFCA & UFTA, *supra* note 40; Bankruptcy Code, 11 U.S.C. §§ 548 (a) (1) (B). Aside from the loan funds received, the debtors also retained ownership of the stock and any "equity" in the collateral beyond the amount due on the loan. *See generally* UCC Article 9 §§ 9-615, 9-616 & 9-623.

44. *See, e.g.*, Dean v. Davis, 242 U.S. 438, 37 S.Ct. 130, 61 L.Ed. 419 (1917). As noted, in *GRAND JURY* the debtors subsequently used the loan proceeds to purchase exempt property. *See supra* this text and notes 15-17. However, arguably at least, these were separate transactions. *Id.*

45. *GRAND JURY*, 609 F.3d at 914.

46. *See generally supra* notes 40 & 43.

47. *See, e.g.,* UFCA & UFTA, *supra* note 40.

48. Unless he was a co-conspirator in an entirely fraudulent scheme, an inference that seems unwarranted based on the facts as stated by the court.

49. *GRAND JURY*, 609 F.3d at 914.

50. *See id.* at 917 (concurring and dissenting opinion of J. Bye).

51. *Id.* Even if this is true of the debtors, however, this conclusion seems unwarranted with respect to attorney J.P. *See supra* this text at notes 42-50 and *infra* at notes 55-62. *See also infra* Part III.

52. *See, e.g., supra* notes 19 and 33 and *supra* this text at notes 37-38.

53. *Id. See also* : UFCA § 4 & UFTA § 4 (b) (inferences to be used in determining fraudulent intent); *supra* this text at note 38.

as in *Hanson* and *Tveten*.[54] In *GRAND JURY,* the Eighth Circuit seemed inclined to build inferences on inferences in an effort to create an analytical edifice in support of the district court's decision.[55]

The Eighth Circuit reasoned that "if [the debtors] had a secret agreement with their relatives to retrieve their property post-bankruptcy," then "it is arguable that their conduct involved illegal concealment."[56] Fair enough, but without more this is merely an assertion based on a supposition, and absent further information of the type relevant under UFTA section 4 (b) (*e.g*., regarding sales prices, market values, evidence of concealment, etc.) this assertion is less than compelling as a dispositive factor. Moreover, there is little or no apparent basis for connecting attorney J.P. to any such scheme. From here, however, the court made a further series of suppositions, concluding that this indicated a "reasonable likelihood that the activity at issue here crossed the line from legitimate pre-bankruptcy exemption planning to a crime or fraud,…using their attorney's advice to structure [the] transactions."[57]

This conclusion does not seem warranted by the record in the case as described by the court. Even accounting for the somewhat murky nature of the issues in such cases, it all seems, *i.e*., a bridge too far.[58] Not only is there a lack of discussion as to seemingly relevant information (*e.g*., the terms and conditions of the sales, market values, and whether the sales resulted in diminution of the debtors' estate[59]), the connection to the attorney's advice is extremely tenuous. The court's opinion provides no indication that attorney J.P. provided any advice relating to a fraudulent concealment or transfer of assets, other than to advise against it. The one transaction that J.P. assisted with was a loan of money *to* the debtors, as part of a contemporaneous exchange of value that apparently was not fraudulent and did not diminish the debtors' estate.[60] The fact that funding for this intra-family loan was provided by the father of one of the debtors may strike the court as odd (though in your author's experience it is not), and perhaps in this particular context it is an arrangement best avoided, but having said that it should be emphasized that there is nothing inherently fraudulent (or damaging) about a parent funding a fair-consideration transaction for his or her child, and this is a different issue from whether the ultimate use of the money by that child constituted fraud or legitimate exemption planning.

A court's analysis of these issues should be based on more than a kind of osmosis, even given the necessity for inferences as to fraudulent intent. As noted,[61] of course, the procedural posture bears on the Eighth Circuit's analysis of these issues. The district court concluded that there was probable cause for a finding of bankruptcy fraud using attorney J.P.'s advice, perhaps making it all but inevitable that the Eighth Circuit would affirm.[62] That may simply reflect some basic limitations of our appellate system. Moreover, it takes a certain judicial courage to speak, as Judge Bye did in his separate opinion,[63] in defense of parties accused of bankruptcy fraud.[64] Instead, the majority opinion specifically found that "the district court properly found" that the debtors and attorney J.P. could not assert the privileges as to these matters.

5. Work Product Privilege: Opinion Versus Non-Opinion Work Product

The Eighth Circuit separately discussed the issues relating to the attorney work product privilege, because of the specialized legal standards applicable to this privilege, and further distinguished between attorney opinion and non-opinion work product.[65] As regards the latter, the court cited a "close connection" between the misconduct of attorney J.P.'s clients and J.P.'s legal advice, in concluding that the government had shown a "substantial need" for J.P.'s non-opinion work product.[66] The court noted that the government would need to "prove both the exact nature of the transactions and the clients' intent at the time they were undertaken."[67] Because attorney J.P. did not contend that the relevant materials were available any other way, the Eighth Circuit concluded that the district court did not err in compelling J.P. to produce the relevant non-opinion work product.[68]

The district court also held that attorney J.P.'s opinion work product was subject to discovery, "because there was probable cause to believe J.P. was complicit in his clients' unlawful activity."[69] The Eighth Circuit found that this conclusion was not an abuse of the district court's discretion, in that "J.P.'s prior experience in the area of bankruptcy law should have made obvious to

54. *See infra* Part IV. The standards provided at UFTA § 4(b) are apparently directed at this problem.

55. As noted, to some extent this reflects the procedural posture of the case. *See supra* note 33. But *see* UFTA § 4 (b); and *infra* Part III.

56. *GRAND JURY*, 609 F.3d at 914.

57. *Id.*

58. *See, e.g.*, Ryan Cornelius, A Bridge Too Far (1974) (describing World War II's failed "Operation Market Garden").

59. *See, e.g.*, Rutledge v. Johanson, 270 F.2d 881 (10th Cir. 1959) (no preferential transfer unless there is a diminution of the estate); *infra* note 87.

60. *See supra* this text and notes 12-20. As previously noted, there could be other factors that would change this conclusion. But none were noted in the *GRAND JURY* opinion.

61. *See supra* notes 33 and 55.

62. It is, of course, difficult for an appellate court to reverse on mixed questions of fact and law, especially at this stage of litigation. Still, difficult is not the same as impossible, and the Eighth Circuit might be expected to be mindful that, in the words of Sol Watcher, former New York Court of Appeals Chief Judge: "District attorneys have so much influence on grand juries that, by and large, they could get them to indict a ham sandwich," *available at* http://www.barrypopik.com/index.php/new_york_city/entry/indict_a_ham_sandwich/. *See also infra* this text and notes 127-130.

63. *GRAND JURY*, 609 F.3d at 916.

64. This is not to suggest in any way that the majority opinion lacks courage. But upholding a defense of transactions alleged to constitute bankruptcy fraud has the potential to be unpopular.

65. *See supra* Part II.C.1.

66. *GRAND JURY*, 609 F.3d at 915.

67. *Id.*

68. *Id.*

69. *Id.* As noted below, this conclusion seems unwarranted. *See also supra* this text at notes 56-64.

him the distinction between legitimate exemption planning and bankruptcy fraud."[70] It was not enough that attorney J.P. warned his clients about the legality of transferring assets to close relatives and retrieving the assets post-bankruptcy,[71] because "J.P. later apparently ignored his own advice and helped facilitate the questionable transaction."[72]

The Eighth Circuit also concluded that there was a "reasonable likelihood" that attorney J.P. "either knew or was willfully blind to the fact that his clients were entering sham transactions with relatives so that they could later retrieve their original assets after discharging their debts."[73] It would appear that there is a basic flaw in this reasoning, in that attorney J.P. was being blamed for subsequent (reacquisition) transactions that apparently occurred entirely without his involvement and, as attorney J.P. argued, there was no evidence to indicate that he had prior knowledge or participated in any way in planning these transactions.[74] However, the Eighth Circuit viewed the evidence differently, concluding that it "suggest[ed]" that attorney J.P. "was aware" that his clients "were contemplating" the possibility of reacquiring some of their transferred assets."[75]

In the end, as presented in the Eighth Circuit's opinion, the significant direct evidence against attorney J.P. seems to be limited to the fact that he assisted in sales or pledges of his clients' assets to relatives for full consideration, which they later (and without his assistance) reversed.[76] Given that there is nothing inherently fraudulent about transferring property to a relative for consideration, this seems a stretch as the primary basis for the court's decision, even considering the need for deference to a trial court's discretion.[77]

III. Dissenting Opinion

Judge Bye wrote a separate opinion, concurring in part and dissenting in part.[78] Specifically, Judge Bye dissented from the majority's decision to uphold the district court's application of the crime-fraud exception to attorney J.P.'s assertion of the opinion work product privilege "because of the greater protection afforded opinion work product."[79] Judge Bye noted that "[h]istorically, a lawyer's mental impressions, conclusions, opinions, and legal theories have been afforded substantial protection in order to secure the lawyer's effective advocacy and representation of his or her client's interests."[80] Judge Bye also noted that the United States Supreme Court has "cautioned against the unjustified invasion of a lawyer's work product and the severe consequences that follow…,"[81] and that the Eighth Circuit has interpreted this precedent to confer "nearly absolute immunity" on attorney opinion work product.[82]

Judge Bye then concluded: "I do not believe the instant matter presents the 'rare and extraordinary' case where [attorney] opinion work product may be discovered…."[83] Judge Bye noted that, even if attorney J.P.'s clients were engaged in criminal activity, and "used J.P.'s advice in furtherance of that activity, the government failed to establish [that] J.P. himself knowingly participated in any criminal activity."[84]

Judge Bye's opinion emphasizes that the district court relied on attorney J.P.'s knowledge of the $52,000 loan from a relative to one of the debtors, secured by a stock transfer.[85] However, Judge Bye notes that "this transaction was merely a loan [to the debtor] whereby the stock was pledged as collateral in order [to allow the debtor] to maintain his lifetime healthcare coverage associated with the stock."[86] As such, it had a legitimate purpose; moreover, it was a transfer for full consideration.[87] Furthermore, "[t]he stock remained an asset of [the debtor], and therefore [became] an asset of the bankruptcy estate, which was explicitly disclosed [in the debtor's] bankruptcy filing."[88] Judge Bye concluded that the evidence reviewed and cited by the district court and Eighth Circuit, "at best, demonstrates that [attorney] J.P. helped [the debtor] effectuate [this] loan; it does not establish [that attorney] J.P. assisted [the debtors] in wrongly reacquiring the stock, or any other assets, post-bankruptcy."[89]

The connection between attorney J.P.'s assistance with an apparently bona fide loan transaction and the debtor's alleged (and far removed) subsequent fraudulent conduct seems extraordinarily tenuous, and far from sufficient as the basis for an inference to overcome the "almost absolute immunity" afforded attorney opinion work product.[90] As stated by Judge Bye in his dissent: "The above circumstances demonstrate

70. *GRAND JURY*, 609 F.3d at 915. This variation in the applicable legal standard based on the attorney's level of experience is not a common factor in other case law. *See, e.g., infra* Part IV.

71. *GRAND JURY*, 609 F.3d at 915. In a footnote to this discussion, the Eighth Circuit states that J.P. also should have known that a court could "find fraud in his clients' attempt to shield virtually all of their assets from creditors" in bankruptcy. *But see infra* this text at note 74, and *infra* Part III.

72. *GRAND JURY,* 609 F.3d at 915. *But see supra* Part II.C.5., and discussion of dissent, *infra* at Part III.

73. *GRAND JURY,* 609 F.3d at 915.

74. *Id.*

75. *Id.* This seems a slender thread of suppositions and potential motives, as the basis for such a drastic conclusion and result. *See infra* Part III.

76. *GRAND JURY*, 609 F.3d at 915.

77. Which is noted, *id*. *But see supra* note 62; *infra* this text and notes 127-130.

78. *GRAND JURY,* 609 F.3d at 916 (J. Bye, concurring in part & dissenting in part).

79. *Id.*

80. *Id.* (*quoting In re* Special September 1978 Grand Jury (II), 640 F.2d 49, 63 (7th Cir. 1980), stating that "It has been a very rare case, indeed, in which inquiry has been permitted into the internal operation of the lawyer's office.").

81. *Id.* (*citing* Hickman v. Taylor, 329 U.S. 495, 510-511, 67 S.Ct. 385, 91 L.Ed. 451 (1947)).

82. *Id.* (*citing In re* Murphy, 560 F.2d 326, 336 (8th Cir. 1977)).

83. *Id.* at 917.

84. *Id. See generally supra* Part II.C.5.

85. *GRAND JURY,* 609 F.3d at 917.

86. *Id.*

87. And did not directly result in diminution of the debtor's estate. *See, e.g.*, the still relevant and classic analysis of similar issues by Judge Alfred P. Murrah in Rutledge v. Johansen, 270 F.2d 881 (10th Cir. 1959); *infra* this text and notes 88 & 89.

88. *GRAND JURY*, 609 F.3d at 917.

89. *Id.* (noting also that the evidence indicated that attorney J.P. did not even know about the reacquisition of the stock until the day of the debtor's grand jury testimony, and that J.P.'s representation of the debtors had ceased prior to the debtors' bankruptcy filing). *See generally supra* Part II.C.5.

90. *See supra* this text at notes 79-84.

[that attorney] J.P.'s conduct appears more aligned with legitimate exemption planning than fraudulent activity."[91]

Judge Bye concluded that the government "failed to present a compelling showing that [attorney] J.P. was knowingly complicit in any criminal activity," particularly "[g]iven the near absolute immunity afforded opinion work product[.]"[92] Moreover, he emphasized that "the freedom from intrusion [that] lawyers enjoy and require for their opinion work product must be protected in order to [allow lawyers to] best serve their clients' interests and maintain the integrity of the legal system."[93] The concerns expressed in Judge Bye's separate opinion seem compelling on these points, and it seems surprising that the majority did not give them more attention.

IV. *Hanson* and *Tveten*

A. Introduction

There is at least a minor irony in that *GRAND JURY*[94] was decided by a panel of the Eighth Circuit, the same circuit that decided two of the most famous (some might say infamous) fraudulent transfer cases of modern times. In *Hanson v. First National Bank in Brookings*[95] and *Norwest Bank Nebraska v. Tveten,*[96] the Eighth Circuit decided two seemingly similar cases very differently, in ways that (to this day) may leave an observer scratching his or her head in confusion.[97]

B. The *Hanson* Case

In *Hanson*, a bank (First National) loaned money to debtors who were farmers. Prior to filing bankruptcy (and after consultation with a bankruptcy lawyer, who advised them with respect to the transactions in question) the debtors sold certain non-exempt property to their sons (a car, two vans, and a motor home were sold to one son; household goods and furnishings were sold to another son). A few weeks prior to filing bankruptcy the debtors used some of the proceeds of these sales to purchase exempt life insurance policies, and two days before filing bankruptcy they used other such proceeds to prepay $11,033 on the mortgage loan covering their exempt homestead. The debtors retained possession and use of the property allegedly sold to their sons.

First National objected to these transfers as being fraudulent in that they were eve-of-bankruptcy transfers that diminished the debtor's bankruptcy estate,[98] *i.e.*, transfers that converted non-exempt property into exempt property with the apparent purpose of defrauding creditors by diminishing the bankruptcy estate.[99] In support, First National noted the following traditional "badges of fraud": The property sold was never transferred to the buyers; the debtors retained possession and continued their use of the property as before the sale (the household goods were sold to a son who lived in Alaska and had no apparent use for the goods); and the only apparent purpose and result of the transfers was to diminish the bankruptcy estate available to pay creditors.[100]

These abuses are more blatant than anything in the *GRAND JURY* case, yet First National's arguments were rejected by the bankruptcy court, the district court, and ultimately the Eighth Circuit.[101] The Eighth Circuit was emphatic: "It is well established that under the [Bankruptcy] Code, a debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he would otherwise be entitled."[102] The *Hanson* court then noted that there is a fraud exception, where the debtor "acts with actual intent to defraud creditors…," and stated that the "crux of the issue" in *Hanson* was "whether there was extrinsic evidence to establish that the Hanson's transferred the property with intent to defraud their creditors."[103]

First National contended that the traditional "badges of fraud" evident in the case[104] were sufficient to create a presumption of fraud,[105] citing *In re Cadarette*.[106] In *Cadarette,* the debtor transferred valuable personal property to his fiancée without consideration, three weeks before filing bankruptcy. The debtor's discharge was denied on the basis of his fraudulent intent;[107] a significant factor was the debtor's continued use of the property transferred (a vehicle) after its alleged sale (a factor also present in *Hanson*).

The *Hanson* court found its case to be "quite different" from *Cadarette*, emphasizing that in *Hanson* (unlike *Cadarette*) the buyers paid full value for the property transferred, and concluding that in *Hanson* "the debtors had reasonable explanations as to why the property they sold remained on their premises."[108] The

91. *GRAND JURY*, 609 F.3d at 917 (*quoting In re* Addison, 540 F.3d 805, 813 (8th Cir 2008), as follows: "It is well settled that the mere conversion of non-exempt assets to exempt assets is not in itself fraudulent activity.").

92. *GRAND JURY*, 609 F.3d at 917.

93. *Id.*

94. *Id.*

95. 848 F.2d 866 (8th Cir. 1988).

96. 848 F.2d 871 (8th Cir. 1988).

97. Perhaps as a result, the two cases are featured prominently in law school case books to this day. *See, e.g.*, William D. Warren & Daniel J. Bussel, Bankruptcy 66-74 (6th ed. 2002); *see also supra* note 5.

98. *Hanson,* 848 F.2d at 867.

99. On the issue of diminution of the estate, *see, e.g.*, *Rutledge*, 270 F.2d 881 (cited *supra* at notes 59 & 87).

100. *Hanson,* 848 F.2d at 867-68; *see also Rutledge*, 270 F.2d 881; Twynes Case, 3 Coke 80b, 76 Eng. Rep. 809 (1601); discussion *infra* at Part V.B.

101. *Hanson,* 848 F.2d at 866 - 69.

102. *Id.* at 868. It should be noted that the sanction being sought by First National (a denial of the debtors' claim for an exemption covering the proceeds of the contested sales) was far less severe than that being imposed in the *GRAND JURY* case, yet even that relatively mild sanction was denied in *Hanson*.

103. *Hanson,* 848 F.2d at 868.

104. *See, e.g., supra* note 100 and accompanying text.

105. *See Hanson,* 848 F.2d at 869.

106. 601 F.2d 648 (2d Cir. 1979).

107. *Id.*; *see also* the Bankruptcy Code, 11 U.S.C. § 727.

108. *Hanson,* 848 F.2d at 869. The latter conclusion seems particularly weak on the facts in *Hanson*. In contrast, this argument seems strong on the facts in *GRAND JURY*. Yet the argument was accepted in *Hanson* and rejected in *GRAND JURY*. *In*

(Continued on next page)

Eighth Circuit then affirmed the decisions of the lower courts, essentially agreeing with the bankruptcy court that "First National did not establish any indicia of fraud…."[109] This does not square with the traditional Rule in *Twynes Case,*[110] or the obvious and significant point that in both *Hanson* and *Cadarette* the result of an eve-of-bankruptcy insider transaction was to diminish the estate available to satisfy the claims of creditors.[111] Even more dramatically, the analysis in *Hanson* does not support the severe sanction imposed in *GRAND JURY,* on seemingly less egregious facts. But, from an analytical standpoint at least, these disparities got even worse, in the *Tveten* decision.

C. The *Tveten* Case

In *Norwest Bank Nebraska v. Tveten*,[112] decided the same day as *Hanson*, the Eighth Circuit considered analytically-similar issues, the apparent differences being that in *Tveten* the debtor was a doctor (rather than a farmer, as in *Hanson*), and the dollar amounts were significantly larger.

Dr. Tveten was fifty-nine years old and engaged in a general practice of medicine. He had invested in (and personally guaranteed) various leveraged real estate ventures that turned "sour," leaving him with debts of roughly $19 million that were beyond his ability to repay. Before filing a Chapter 11 bankruptcy petition, he liquidated most of his remaining non-exempt property in seventeen separate transfers (which included sales of land to relatives and cashing in non-exempt life insurance policies). As in *Hanson*, there was no allegation that the transactions were for less than fair market value.[113] The proceeds were reinvested in exempt life insurance and annuity contracts. The relevant facts are quite similar to those in *Hanson,* though arguably less egregious because the transfers were fully disclosed and Dr. Tveten did not retain possession of any of the property transferred.

The bankruptcy court denied Dr. Tveten's request for a discharge on grounds that these transactions evidenced an intent to defraud creditors.[114] The district court affirmed, and Dr. Tveten appealed to the Eighth Circuit, contending that the lower courts relied on improper factors to infer a fraudulent intent.

Early in its analysis, the Eighth Circuit cited legislative history relating to the Bankruptcy Reform Act of 1978, in the form of House and Senate Reports specifying an intent to retain the rule that conversion of non-exempt property into exempt property before bankruptcy is not *per se* fraudulent.[115] The Eighth Circuit then agreed with the bankruptcy court that the issue in *Tveten* was "whether there was extrinsic evidence to demonstrate that Tveten transferred his property on the eve of bankruptcy with intent to defraud his creditors."[116]

The Eighth Circuit opinion discusses several other cases dealing with this issue;[117] however, at least to this author, none seem compelling with respect to the facts of *Tveten*. The court distinguished cases upholding the debtor's discharge in similar circumstances,[118] on grounds that in *Tveten* the state exemption was unlimited (allowing Dr. Tveten to exempt almost his entire remaining net worth of $700,000); however, that is essentially going to be the result of pre-bankruptcy planning in many such cases, and the Bankruptcy Code does not appear to reference this as a deciding factor. Nor is there any suggestion in the Bankruptcy Code that it is the role of a federal court to deny a discharge on the basis that a state exemption law is too generous.

In the end, the Eighth Circuit seemed unable to explain the rationale for its decision, other than to say that it did not find the bankruptcy court's decision to be clearly erroneous. Indeed, the only apparent consistency between the Eighth Circuit's simultaneous holdings in *Hanson* and *Tveten* is that the court was affirming the lower court in each case. Perhaps this procedural posture (reflecting a deference to the trier of fact as the appropriate standard of review) is the only real lesson from these cases; certainly there is little in the way of substantive law or analysis to explain the disparate results on such similar facts.

Ultimately, the Eighth Circuit attempted to distinguish *Hanson* and *Tveten* on grounds that the former was based on objections to exemptions claimed under state law, while *Tveten* involved the issue of non-dischargeability under Bankruptcy Code section 727. However, this difference cuts the other way: The result was to impose on Dr. Tveten a penalty (denial of a discharge) far more severe than the more limited sanction (denial of an exemption) rejected on similar facts in *Hanson*. However, this merely emphasizes the unexplained disparity between the two cases.

D. Judge Arnold's Concurring and Dissenting Opinions

The most sensible parts of the *Hanson* and *Tveten* appellate decisions are Judge Arnold's concurrence

108. *(Continued from previous page)*

Hanson, the Eighth Circuit even recognized First National's assertion that the debtors' position was undermined by the debtors' own bankruptcy schedules, which listed the debtors as owning some of the property allegedly transferred; however, the court declined to consider this fact on grounds it was not properly raised in the bankruptcy court. *Id.*

109. *Id.*

110. *Twynes Case* established the principle that a sale by an insolvent debtor not accompanied by an open and notorious change of possession is presumed to be a fraud on creditors. *See* Twynes Case, 3 Coke 80b, 76 Eng. Rep. 809 (1601); *supra* note 100. *See generally infra* note 132 (indices of fraud under the UFTA); and *infra* Part V.D.

111. Judge Arnold's concurring opinion in *Hanson* makes additional points, but in this article consideration of these issues is deferred until after discussion of the *Tveten* decision, below.

112. 848 F.2d 871 (8th Cir. 1988).

113. *Id.* at 873, n.1.

114. *Id.* at 873; *see also* 11 U.S.C. § 727(a)(2). Although Dr. Tveten filed under Chapter 11, the section 727 discharge rules applied. *See* 11 U.S.C. § 1141(d)(3)(C); *see also Tveten*, 848 F.2d at 874. Note, again for purposes of comparison, that the sanction imposed on Dr. Tveten was much more severe than that rejected for the debtor in the *Hanson* case, which was decided on the same day. *See also supra* notes 102 and 108 for other examples of this incongruity.

115. *Tveten*, 848 F.2d at 874.

116. *Id.*

117. Including: Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir. 1926); and *In re* Reed, 700 F.2d 986 (5th Cir. 1983). *See Tveten*, 848 F.2d at 874-76.

118. *See, e.g., In re* Ellingson, 63 B.R. 271 (N.D. Iowa 1986).

in *Hanson*[119] and dissent in *Tveten*.[120] In *Hanson*, Judge Arnold concurred in the result and "almost all" of the court's reasoning, concluding that there was no evidence of "extrinsic fraud" in the debtors' efforts to maximize their legal exemptions.[121] Moreover, Judge Arnold provided illustrations that (by negative implication) suggest what might indicate fraud, noting that in *Hanson*: "[t]he money placed into exempt property was not borrowed[;] the cash received from sales was accounted for[;] and the property was sold for fair market value."[122] Importantly, "[t]he fact that the sale was to family members, 'standing on its own, does not establish extrinsic evidence of fraud.'"[123] On all of these points, Judge Arnold agreed with the majority.[124]

However, in the *Hanson* concurrence Judge Arnold noted that all of the same could be said in *Tveten*.[125] He then noted that there are only three factual differences between the *Hanson* and *Tveten* cases, and that all three are irrelevant to the legal analysis: (1) Tveten was a doctor, while the Hansons were farmers; (2) Tveten claimed exemptions of $700,000, while the Hansons claimed roughly $31,000; and (3) Tveten was in a state that did not place a dollar limit on insurance exemptions, while the Hansons were in a state with a $20,000 limit.[126]

Judge Arnold then addressed the attempts of the majority to reconcile the widely disparate results in these two analytically indistinguishable cases, *e.g.*, the majority's effort to characterize the issue as one of fact within the sole purview of the trier of facts.[127] In the majority's view, Judge Arnold said, the bankruptcy court found fraudulent intent in *Tveten* but not in *Hanson*, and these findings could not be disturbed on appeal unless clearly erroneous.[128] There was no clear error, according to the majority, so both holdings were affirmed.[129] However, as Judge Arnold then noted:

> This analysis collapses on examination [, because] in *Tveten* the major indicum of fraudulent intent relied on by the Bankruptcy Court was Dr. Tveten's avowed purpose to place the assets in question out of reach of his creditors, a purpose that, as a matter of law, cannot amount to fraudulent intent, as the Court's opinion in *Hanson* explicitly states. The result in practice, appears to be this: a debtor will be allowed to convert property into exempt form, or not, depending on findings of fact made in the court of first instance, the Bankruptcy Court, and these findings will turn on whether the Bankruptcy Court regards the amount of money involved as too much. With all deference, that is not a rule of law. It is simply a license to make distinctions among debtors that will vary more widely than the length of the chancellor's foot.[130]

Judge Arnold's dissent in *Tveten* follows the pattern of his concurrence in *Hanson*, but emphasizes some factual elements that bolster the points made in the *Hanson* concurrence.[131] Judge Arnold's *Tveten* dissent notes that, in contrast to the commonly understood legal definition of "fraud,"[132] Dr. Tveten "never made any bones about what he was doing, or trying to do…."[133] There was no effort whatsoever to hide or disguise his transactions, and there was full and proper disclosure at every stage. There was no allegation that Dr. Tveten did anything other than convert non-exempt assets into exempt assets in order to maximize his legal exemptions. Although, in a "non-legal sense," this "involves an attempt to delay or hinder creditors,…under longstanding principles embodied both in judicial decisions and in statute, such a purpose is not unlawful."[134] Therefore, "[i]t is well settled that it is not a fraudulent act by an individual who knows he is insolvent to convert [non-exempt] property into property which is exempt, for the purpose of claiming…exemptions, and…thereby placing it out of the reach of his creditors."[135]

It appears that this lawful activity is precisely what Dr. Tveten was accused and found guilty of. Of course, as Judge Arnold noted:

> [I]f there is extrinsic evidence of fraud, or of a purpose to hinder or delay creditors, discharge may and should be denied, but "extrinsic" in this context must mean something beyond the mere conversion of assets into exempt form for the purpose of putting them out of reach of one's creditors.[136]

119. *Hanson*, 848 F.2d at 870 (J. Arnold, concurring) [*Hanson* concurrence].

120. *Tveten*, 848 F.2d at 877 (J. Arnold, dissenting) [*Tveten* dissent].

121. *Hanson* concurrence, 848 F.2d at 870.

122. *Id.*

123. *Id.* (quoting the majority opinion, 848 F.2d at 868).

124. *Id.*

125. *Id.*

126. *Id.* Judge Arnold went on to explain why each of these differences is irrelevant. *Id.*

127. *Id.*

128. *Id.*

129. *Id.* Arguably, this procedural posture offers the best explanation for the disparate results in *Hanson* and *Tveten*. *But see* discussion immediately below and *infra* at Part IV.E.; *see also supra* notes 62, 77 & 102-108, and accompanying text.

130. *Hanson* concurrence, 848 F.2d at 870-71.

131. *Tveten* dissent, 848 F.2d at 877.

132. *Id. See, e.g.*, UFTA § 5 (a transfer or obligation is fraudulent as to existing creditors only if made for less than a reasonably equivalent value or to an insider for an anticedent debt, by an insolvent debtor); *see also id.* § 4(a) (a transfer or obligation *(Continued in next column)*

132. *(Continued from previous column)*

is fraudulent as to present or future creditors if made with actual intent to hinder, delay or defraud; or without a reasonably equivalent exchange of value in a transaction leading, *i.e.*, to insolvency); *see also id.* § 4(b) (factors to consider in determining whether there was an actual intent to defraud). *See also infra* Part V.D.

133. *Tveten* dissent, 848 F.2d at 877.

134. *Id. See also supra* this text at note 123. If it were otherwise, all exemption planning would be unlawful. No doubt this is a reason for coupling the relevant language in the statutes with a requirement for evidence of "actual intent" to defraud. *See, e.g.*, UFCA § 7; and the Bankruptcy Code, 11 U.S.C. § 548. *See also infra* Part V.D.

135. *Tveten* dissent, 848 F.2d at 877 (quoting Forsberg v. Security State Bank, 15 F.2d 499, 501 (8th Cir. 1926)). *See also* similar language in the *Hanson* concurrence, 848 F.2d at 870.

136. *Tveten* dissent, 848 F.2d at 878. *See also* similar language in the *Hanson* concurrence, 848 F.2d at 870.

Citing and contrasting the case law relied on by the majority, Judge Arnold noted that (unlike those cases) the debtor in *Tveten* did not lie to his creditors, mislead them in any way, or transfer assets to a third party for less than full value.[137]

It is important to emphasize here, as in Judge Arnold's dissent, that in *Tveten* there was no allegation whatsoever of any such improper or illegal behavior.[138] A possible explanation for the court's decision is that it was offended by the size of the resulting exemption ($700,000), but as Judge Arnold pointed out this is a function of state law and legislative policy: "Where courts punish debtors simply for claiming exemptions within statutory limits, troubling problems arise in separating judicial from legislative power."[139]

Judge Arnold concluded that the result of cases like *Hanson* and *Tveten* can only be a "rule" of law, as characterized by Judge Arnold, that "when a pig becomes a hog it is slaughtered."[140] The result of such an ineffective non-rule can only be that interested parties are left entirely in the dark as to what constitutes permissible behavior. As Judge Arnold noted: "…[S]itting as a judge, by what criteria do I determine when this pig becomes a hog?"[141] Observing that the majority opinion provides no answers to the relevant questions, he opined that the court's decision leaves the necessary distinctions "to each bankruptcy judge's own sense of proportion."[142]

Judge Arnold concluded by noting that "Tveten did nothing more fraudulent than seek to take advantage of a state law of which the federal courts disapprove."[143] It is a point well taken, and remains a valid criticism that illustrates a weakness in fraudulent transfer law that continues to haunt ordinary transactions nearly twenty-five years later.[144]

E. Author's Observations

To this day, Judge Arnold's comments remain refreshingly candid and explanatory, if not instructive. It is extraordinary that the law has evolved so little as to such fundamental and important issues. As a result, Judge Arnold's observations as to the consequences for the rule of law, and the expectations of debtors and their counsel,[145] remain valid (as illustrated once again in *GRAND JURY*[146]).

In both *Hanson* and *Tveten* the basic question was whether an open and disclosed transfer of property on the eve of bankruptcy, for the purpose of maximizing state law exemptions, constituted an effort to hinder, delay, or defraud creditors so as to be considered a fraudulent transfer.[147] To this extent the *Hanson* and *Tveten* cases are indistinguishable (and therefore irreconcilable), as between themselves and with *GRAND JURY*. As noted,[148] the difference in the remedies being sought was cited by Judge Timbers (writing for the majority in *Hanson* and *Tveten*) as an explanation for the differing results, but this actually cuts the other way: The remedy sought (and imposed) in *Tveten* (denial of the discharge under Bankruptcy Code sections 1141(d)(3)(C) and 727(a)) is much more severe than the modest remedy sought (and rejected) in *Hanson* (disallowance of the resulting exemption). Thus, consideration of the remedies issues widens, rather than narrowing, the gaps between the two cases. The same can be said of a comparison with *GRAND JURY*, which upheld a truly extraordinary (and potentially dangerous) remedy on seemingly less egregious facts.

As noted by Judge Arnold, *Hanson* illustrates the generally-accepted rule that conversion of non-exempt into exempt assets, even on the eve of bankruptcy, is not fraudulent absent extrinsic evidence of fraud (such as, *e.g.*, concealment).[149] Moreover, transfers to relatives for full consideration are likewise not a proper basis for objection. Of course, in a non-legal sense any of this could be viewed as an effort to "hinder" or even "delay" creditors,[150] but absent fraudulent intent the courts (and legislatures) generally do not see it that way.[151]

The problem, of course, is identifying fraudulent intent. This intent must be actual (not presumed[152]), and the basic problem in reconciling *Hanson, Tveten* and *GRAND JURY* is that the three cases are virtually identical as to this core issue. The wildly disparate judicial results on virtually identical material facts, and the court's blatant failure in each case to provide an analytically satisfactory explanation, again illustrate Judge Arnold's point that the resulting lack of consistency and objectivity is inconsistent with a rule of law.

Of course, there are some transfers that are so blatantly fraudulent that almost any court would likely deny the exemption, avoid the transfer, or possibly even deny the debtor a discharge or assertion of the privileges. These might include such things as direct attorney involvement in undisclosed transfers to relatives or friends without consideration, other concealment of assets, and falsifying bankruptcy schedules. But these are the easy cases, and do not do much to address the line-drawing needed in the vast majority of cases, such as those discussed here. The subjective lack of standards illustrated and

137. *Tveten* dissent, 848 F.2d at 878.

138. *Id*. "There is absolutely no evidence of that sort of misconduct in this record, and the Court's opinion filed today cites none." *Id*.

139. *Id*.

140. *Id*. at 879 (*quoting In re* Zouhar, 10 B.R. 154 (Bankr. D. N.M. 1981)).

141. *Id*. (noting the various factors that could be considered in *Tveten*, and that they are all legally irrelevant).

142. *Id*.

143. *Id*.

144. As illustrated in *GRAND JURY*, 609 F.3d 909. *See supra* this text Parts II. & III.; and discussion below.

145. *See supra* this text at notes 140-142.

146. *See supra* note 144.

147. *See, e.g.*: UFTA §§ 4 & 5; UFCA § 7; Bankruptcy Code, 11 U.S.C. § 548(a) (1) (A); *infra* this text Part V.D.; *supra* note 132.

148. *See supra* this text following note 118.

149. *See*: UFTA § 4(a)(1), (b); UFCA § 7; Bankruptcy Code, 11 U.S.C. § 548(a) (1) (A); *infra* Part V.D.; *supra* this text and notes 132-137.

150. *See supra* note 149.

151. *Id*.

152. *Id*.

articulated in cases like *Hanson*, *Tveton* and *GRAND JURY* do little or nothing to shed light on this problem.

In the end, the only likely explanation for the results in these cases is the "pig and hog" analogy cited by Judge Arnold,[153] *i.e.*, that the court majorities did not think it right for a relatively high-income or high-asset debtor to use bankruptcy in conjunction with unlimited state exemptions to avoid paying anything to his or her creditors.[154] This is a legitimate concern, and one that was (in a broader sense) addressed more appropriately in the 2005 Bankruptcy Code amendments, as noted below.[155] But, however much one may agree with that sentiment, it is difficult to argue that conjuring an inappropriate allegation of fraud based on inferences is the best solution to the problem. Perhaps, and hopefully, the 2005 Bankruptcy Code amendments[156] provide more rational approaches to dealing with these issues. But in the meantime, cases like *Hanson* and *Tveton* leave us with something of a legal hangover in this area of law, as illustrated by the *GRAND JURY* case. As a result, it is often difficult for debtors (and lawyers) to understand what standards are applicable to pre-bankruptcy (or other) debtor-related financial planning transactions. Penalizing lawyers, as in *GRAND JURY*, expands the harm and creates an uncertain legal climate in which some lawyers may be overly conservative in protecting their client's interests, while others inadvertently may err on the side of excessive pre-bankruptcy transfers and planning.

V. The 2005 Bankruptcy Code Amendments

A. Introduction

The 2005 Bankruptcy Code amendments[157] address some of the underlying issues involved in *GRAND JURY, Hanson* and *Tveton*, perhaps alleviating some of the pressures to address abusive pre-bankruptcy planning by convoluted judicial applications of the fraudulent transfer laws. One example in the 2005 Bankruptcy Code amendments is commonly referred to as the "means test."

B. The Means Test

The means test appears at Bankruptcy Code section 707(b). It is not the purpose of this discussion to describe the means test in detail,[158] but rather to note its place within the context of the 2005 Bankruptcy Code amendments as an alternative means to address cases like *GRAND JURY*, *Hanson* and *Tveten*.

The means test is designed to prevent relatively high-income debtors from shielding their future disposable income from creditors' claims by filing under Chapter 7 of the Bankruptcy Code.[159] Under the BAPCPA, a debtor seeking a Chapter 7 discharge must provide detailed financial information (including income and expenses),[160] and demonstrate an inability (based on projected postpetition income) to pay a reasonable amount to unsecured creditors over a five-year period.[161] Otherwise, a rebuttable presumption arises that a Chapter 7 discharge would be abusive;[162] essentially this requires the debtor to file under Chapters 11 or 13, which in turn require payment of the debtor's disposable income to unsecured creditors.[163] Other Bankruptcy Code revisions restrict such things as sequential filings.[164]

While not directly addressing the issues in cases like *Grand Jury*, *Hanson,* and *Tveten*, these changes are designed to reduce the potential for abuse of the bankruptcy discharge, perhaps thereby relieving some of the pressure for courts to use creative interpretations of fraudulent transfer law to prevent such abuses.

C. BAPCPA Revisions to Section 522

Other provisions added by the 2005 Bankruptcy Code amendments address pre-bankruptcy planning issues even more directly. For example, Bankruptcy Code section 522(b)(3)(A) now limits the ability of a debtor to "forum-shop" for a maximum homestead exemption, by requiring that a debtor reside in a state for at least 730 days (essentially, two years) prior to filing bankruptcy in that state and claiming its homestead exemption. Section 522(p) limits the debtor's homestead exemption to $125,000 (adjusted for inflation) if the debtor has not owned the homestead (or a predecessor) for at least 1,215 days (roughly three and one-third years) before the bankruptcy filing. And section 522(q) prohibits a homestead exemption claim in excess of $125,000 (as adjusted for subsequent inflation) if the debtor has been convicted of a felony involving abuse of the bankruptcy system or owes a debt for violation of securities laws or fraud in a fiduciary capacity.[165]

Additionally, section 522(o) now provides that a debtor's homestead

153. *See supra* this text at notes 140-142.

154. There is a potential statutory basis for this in the Bankruptcy Code, at 11 U.S.C. § 105. However, regarding the limits of a bankruptcy court's authority to use its general equity powers to override state laws not otherwise preempted by the Bankruptcy Code, *see, e.g.*: Butner v. United States, 440 U.S. 48 (1979); *In re* Wright, 492 F.3d 829 (7th Cir. 2007). As stated by Professor William D. Warren and Daniel J. Bussel in their Bankruptcy case book, "the *Butner* principle hovers over all bankruptcy law; woe to bankruptcy lawyers who ignore it by casually assuming that state law no longer governs the rights and liabilities of the parties…." William D. Warren & Daniel J. Bussel, Bankruptcy 34 (8th ed. 2009). *See also* the Bankruptcy Code at 11 U.S.C. § 548 (providing specific fraudulent transfer rules similar to the UFCA and UFTA).

155. *See, e.g.*, discussion of the "means test" *infra* at Part V.B.

156. *See supra* Part V.

157. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA or the 2005 Bankruptcy Code amendments).

158. *See generally, e.g.*, Fred H. Miller & Alvin C. Harrell, the abcs of the UCC Related Insolvency Law 10 - 20 (2006).

159. *See, e.g., id.* Dr. Tveten filed under an earlier version of Bankruptcy Code Chapter 11; companion 2005 revisions to that Chapter and Chapter 13 in the BAPCPA now limit the ability of debtors with disposable income to confirm near "zero payment" plans that are equivalent to a Chapter 7 liquidation. *See, e.g.*, Bankruptcy Code, 11 U.S.C. §§ 1129(a)(15), 1325(b). Thus, basic elements of the discussion below relating to the means tests for Chapter 7 are also widely applicable in Chapters 11 and 13.

160. *See* Bankruptcy Code, 11 U.S.C. § 707(b)(2)(C).

161. *See id.* § 707(b)(2)(A).

162. *Id.*

163. *See, e.g., supra* note 15; *see also* Bankruptcy Code, 11 U.S.C. § 1322 (a)(4).

164. *See* Bankruptcy Code, 11 U.S.C. §§ 727(a)(8), 1328(f).

165. *See* Bankruptcy Code, 11 U.S.C. §§ 522 (b)(3)(A), 522 (p) & 522(q). In addition, in a case where such behavior is alleged the court can delay granting a discharge until the issue is settled. *See id.*, §§ 727(a)(12) & 1328(h).

exemption will be reduced to the extent the debtor has fraudulently converted non-exempt property into exempt homestead property within ten years prior to the bankruptcy filing.[166] However, while this ten year "look-back" period is significant, it does not address the basic issue under the UFCA and the UFTA (and Bankruptcy Code section 548), as presented in cases like *GRAND JURY, Hanson* and *Tveten*, as to what constitutes actual fraud. Nonetheless, the BAPCPA revisions to section 522 make it more likely that abusive homestead exemption planning will be addressed on a consistent statutory basis rather than an ad hoc judicial basis.

D. Bankruptcy Code Section 548; UFTA

Section 548 contains the Bankruptcy Code provisions directly governing avoidance of fraudulent transfers.[167] It was revised as part of the 2005 Bankruptcy Code amendments to, *e.g.*, extend the basic "look-back" periods for fraudulent transfers from one to two years[168] and provide a new ten year look-back period for avoidance of transfers by the debtor to a self-settled trust or "similar device," made with actual intent to hinder, delay, or defraud present or future creditors.[169] Beyond this, however, section 548 sheds little new light on the issues addressed here.

In contrast, UFTA section 4(b) attempts to do so, by listing (nonexclusive) factors to be considered in determining the debtor's "actual intent" for purposes of section 4(a)(1).[170] UFTA section 4(b) recognizes something like the traditional "badges of fraud" traditionally used to create a presumption of fraudulent intent.[171] Although section 4(a)(1) requires evidence of "actual intent," that evidence can be supplied pursuant to section 4(b), thereby essentially preserving the rule of presumptive fraud as provided in *Twynes Case*.[172] Specifically, section 4(b) cites as relevant factors whether: (1) the transfer was to an insider; (2) the debtor retained possession of property purportedly transferred to a third person;[173] (3) the transfer was disclosed or concealed; (4) the debtor had been sued or threatened with suit; (5) substantially all of the debtor's assets were transferred; (6) "the debtor absconded"; (7) "the debtor removed or concealed assets"; (8) the debtor received reasonably equivalent consideration; (9) the debtor was or became insolvent;[174] (10) the debtor contemporaneously incurred a substantial debt; and (11) the debtor transferred assets to a lienor who then transferred them to an insider of the debtor.[175]

While these factors help to clarify the issues at hand, especially compared to the vague analyses in cases like *GRAND JURY, Hanson* and *Tveten*, they do not lend support to those analyses or the results in those cases. Indeed, it can be observed that these factors somewhat support a contrary result in each of those three cases, generally suggesting a lack of fraud in *GRAND JURY* and *Tveten* while providing more in the way of support for a finding of fraud in *Hanson*.[176] Similarly, if anything, the alternative tests for a fraudulent transfer at UFTA section 5 seem to argue against the courts' conclusions in all three of these cases.[177]

VI. Conclusion

Twenty-five years after *Hanson* and *Tveten* were decided, basic issues relating to pre-bankruptcy planning and fraudulent transfer law, as illustrated in those cases, remain largely unresolved, and as evidenced by *GRAND JURY* the resulting problems have been expanded beyond debtors to include their legal counsel. Even more broadly, creditors and their counsel are left with uncertainty as to the standards applicable when creditors need to assert rights in this context.

While fraudulent transfer law inherently involves some flexibility of analysis in order to address evolving and creative practices, the prevailing state of uncertainty on these issues goes beyond that need and may serve as an impediment to legitimate financial planning. It is a result that illustrates the broad-based dangers when courts and other authorities fail to articulate a rule of law.

166. *See* Bankruptcy Code, 11 U.S.C. §§ 522(o) & 548(a). While this provides a very long "look-back" period, it still requires a finding of fraud. *See, e.g., supra* notes 40, 53 & 132; *see also* discussion immediately below; and *infra* Part V.D.

167. This is in addition to state fraudulent transfer laws such as the UFTA, which remain applicable in bankruptcy due to Bankruptcy Code § 544(b). Section 544(b) is essentially a codification of Justice Holmes' famous opinion in Moore v. Bay, 284 U.S. 4 (1931). *See generally* Miller & Harrell, *supra* note 158, at 79-80.

168. *See* Bankruptcy Code, 11 U.S.C. § 548(a)(1), (b).

169. *Id.* § 548(e). Note again that, although section 548(e) and the ten year "look-back" period have extraordinary scope, this still requires evidence of "actual intent" to defraud, perhaps begging the question posed in cases like *GRAND JURY, Hanson,* and *Tveten*. *See supra* note 166.

170. Applicable in bankruptcy cases by reason of Bankruptcy Code section 544(b). *See supra* note 167. UFTA section 4(a)(2) is likewise applicable to bankruptcy cases, but applies only upon a transfer to a third person for less than a fair consideration, without regard to intent.

171. As established in Twynes Case, 3 Coke 80b, 76 Eng. Rep. 809 (1601). *See also supra* notes 100, 110 & 132.

172. *See supra* note 171.

173. Note that this suggests fraud in *Hanson,* but not *Tveten* or *GRAND JURY* (the opposite of the outcomes in those cases).

174. "Insolvency" is defined at UFTA § 2 as an asset-liability test, with a presumption of insolvency for debtors generally not paying their debts as due.

175. UFTA § 4(b)(1)-(11).

176. *See, e.g., id.* § 4(b)(2).

177. *See, e.g., id.* § 5(b) (with regard to *Hanson*).