

Loose Lips Sink Ships and Other Fraudulent Conveyance Lessons

Two recent cases involving fraudulent conveyance actions brought under section 548 of the Bankruptcy Code demonstrate the importance of words spoken and written by the parties contemporaneously with the transaction. Both cases serve as reminders to “say what you mean and mean what you say”. Both cases also provide additional examples of what constitutes reasonably equivalent value in a constructive fraudulent conveyance analysis.



In the case of In re Teligent, Inc., 49 BCD 81 (Bankr. S.D.N.Y. 2008), the court gave greater weight to, and accepted as the truth, certain statements made by the defendant contemporaneously with the transaction, even though they contradicted the written terms of the agreement. In the Teligent case, the defendant was the former CEO and chairman of the debtor. The defendant’s employment agreement had included a \$15 million loan, which would be forgiven if the defendant were terminated other than for cause or if he left for any reason other than a “good reason”. After several years, there was a change in ownership and the defendant left the company. The defendant executed a separation agreement with the debtor at the time, which stated that the loan was forgiven and the defendant was terminated other than “for cause”. In the subsequent bankruptcy of the debtor, the trustee sued the defendant under section 548 of the Bankruptcy Code, alleging the forgiveness of the debt was a constructive fraudulent conveyance.

At the trial, conflicting evidence as to why the defendant left the company was presented. On one hand, the written separation agreement stated that the defendant had been terminated “other than for cause”. If this were true, then the forgiveness of the loan was in accordance with the employment agreement and not fraudulent (or at least not within the time period for setting it aside). However, at the time of the defendant’s departure, he gave an interview which was published in the local newspaper stating that he had been disheartened with new ownership and had decided to move on to other opportunities. The court found that this evidence was more persuasive given the contemporaneous nature of the interview and that the statements were made by the defendant himself. Consequently, the court avoided the release, which caused the defendant to be liable to the estate for the amount of the forgiven loan. If the defendant had declined to comment in the interview as to the circumstances of his departure, the court ruling implies that the defendant would not have been liable. In addition to learning to watch what one says, the other lesson of this case is that a release can constitute a transfer under section 548. If such a release is granted without adequate consideration, it can be avoided as fraudulent.

The second case involving “loose lips” is In re Student Financing Corp., 49 BCD 82 (Bankr. D. Del. 2007). In this case, the debtor was in the business of making loans to students. The debtor had a long lending relationship with SWH Funding Corp. At one point, the debtor approached SWH about obtaining an \$80 million loan. SWH required the payment of an application fee of \$400,000. The debtor later changed its mind and decided not to pursue the loan. However, only a few short weeks later, the debtor decided again it wanted to pursue the loan. SWH charged the debtor an additional \$250,000 application fee. Ultimately, SWH declined to advance any funds to the debtor. In the subsequent bankruptcy case, the trustee sued SWH for the \$650,000 in application fees under section 548 of the Bankruptcy Code, alleging both an actual intent to hinder, delay and defraud creditors and a constructive fraudulent conveyance.

On SWH’s motion for summary judgment, the trustee relied upon an e-mail written by SWH’s president to the debtor’s attorney, who had asked for an update on the status of the loan. The e-mail stated, “No joke, you know from the last SFC [the debtor] deal we have no money. We were just using the old ‘the documents aren’t done’ to get out of financing”. The defendant argued that this remark was intended to be sarcastic. Nevertheless, the court relied upon this e-mail as evidence of actual fraud and constructive fraud. The court noted that, while an opportunity to obtain an economic benefit can be reasonably equivalent consideration, if the chances of obtaining the loan are negligible, the application fee can be constructively fraudulent. Given the e-mail from the lender’s president, the court held there was certainly evidence that the chances of obtaining the loan were negligible. Finally, the court relied upon the e-mail as evidence of the defendant’s lack of good faith when it attempted to raise the good faith defense under section 548.

Again, the moral of the story is to write e-mails cautiously. Nothing should be written in an e-mail that one would not write in a formal letter. Finally, the SFC case provides guidance for lenders as to the ability to retain an application fee if a loan is not ultimately made.

In short, it is important to always remember that anything you say and write in any format is likely to come back to you in the context of litigation. Care should always be used in these circumstances. Additionally, while each of these cases involved words spoken to a third party, remember that interoffice and intercompany e-mails are also discoverable, and any off-hand comments made in an e-mail are likely to be construed in a different light in litigation.

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