

# Intent to Defraud: Does it Apply to Future Creditors?

by Gideon Rothschild, Esq.



Gideon Rothschild

The pall which has arguably settled over the field of asset protection planning in recent months in light of such ill-fated cases as *Federal Trade Commission v. Affordable Media LLC, et al* and *In re Stephen Jay Lawrence*. These cases overshadow the fact that a transfer of assets at a time when no creditors' claims exist remains a legitimate, permissible and most likely, prudent, asset protection planning opportunity.

This fact is supported by a February 15, 1999 decision of the High Court of Justice of the Isle of Man in the matter of *Re the Petition of Christopher Jollian Heginbotham* (reported in the September/October issue of the *International Trust and Estate Law Reports*). Notably, the Isle of Man is a jurisdiction which does not have any specific asset protection legislation and because of that, the *Heginbotham* decision cannot be diminished as a product of some national asset protection agenda.

**The facts:** The facts of the *Heginbotham* case, as well as its legal reasoning and conclusion, are relatively simple. In 1992, the petitioner agreed to sell his estate agency

business to the respondent's company. However, due to a subsequent disagreement between the parties, the sale was never finalized and a suit for specific performance of the contract by the respondent resulted.

In October 1995, the petitioner served a counter-claim against the respondent and in December 1997, the petitioner was awarded a judgment on that counter-claim. In the interim, however, and prior to the service of the petitioner's counter-claim, the respondent had transferred all of the assets of his company, including its goodwill, to two newly-formed companies. One of the companies was incorporated by the respondent's wife and another person, while the other company was incorporated by the respondent and a third party (the latter was formed in August 1995, just two months before the petitioner's counter-claim). The respondent's company was effectively rendered judgment-proof by reason of the transfers.

In June 1998, arguing that the respondent's transfer to these two new companies constituted fraudulent transfers, the petitioner brought his petition seeking an order enabling the enforcement of his judgment (entered against the respondent's original company) against the assets of the two new companies (i.e. seeking transferee liability).

**Applicable law:** The law of fraudulent transfers, in the Isle of Man as well as throughout most of the common law world, dates back to the enactment of the *Statute of Elizabeth* in 1571. It was, therefore, the *Statute of Elizabeth* which the *Heginbotham* court first considered in determining whether the petitioner should be allowed to enforce his judgment against the transferee companies. In pertinent part, the *Statute of Elizabeth* provides:

• for the avoiding and abolishing of feigned, covinous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and

executions, . . . which . . . have been and are devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose, and intent to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts accounts damages, penalties, forfeitures, heriots, mortuaries, and reliefs...

• be it declared, ordained, and enacted . . . that all and every feoffment, gift, grant, alienation, bargain . . . by writing or otherwise, and all and every bond, suit, judgment and execution, at any time had or made . . . to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken . . . to be clearly and utterly void, frustrate, and of none effect; any pretence, colour, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.

The *Heginbotham* court noted, significantly, that "[t]he essential element of the *Statute of Elizabeth* is an 'intent' to 'delay, hinder, or defraud creditors.'" Since the *Statute of Elizabeth* is more than 400 years old, however, the *Heginbotham* court was constrained (as would be any modern court, in any jurisdiction) to consider the effect of more recent statutory authority pertaining to fraudulent transfer law. In this case, the *Fraudulent Assignments Act of 1736* provides in pertinent part:

". . . that all fraudulent Assignments or Transfers [sic] of the Debtor's Goods or Effects shall be void and of no effect against his just creditors, any Custome or Practice to the contrary notwithstanding."

With regard to the *Fraudulent Assignments Act of 1736*, the *Heginbotham* court noted that "[t]here is no reference to 'intent' in the 1736 Act." Significantly, however, the court stated that ". . . the expression 'fraudulent Assignments or Transfers' in the

1736 Act must impute an intent by the debtor to assign or transfer his goods or effects fraudulently, that is in the context of the relationship of debtor and creditor."

**Question of law:** The court then noted the key issue in *Heginbotham* (and, indeed, throughout the asset protection field), to wit: "[D]oes the intent or contrivance to defraud creditors apply only to existing creditors; that is, creditors of the debtor at the date of the assignment or transfer, or also to future creditors?"

**Decision:** The court resolved this question by reference to precedent which provided that "a deed is void against creditors when the debtor is in a state of insolvency, or when the effect of the deed is to leave the debtor without the means of paying his present debts." According to the *Heginbotham* court: "A state of insolvency implies an inability to pay existing or present debts. A person is not in a state of 'insolvency' merely because he may not be able to pay contingent or future debts, which may never materialize. [The precedent] specifically referred to the effect of the deed leaving the debtor 'without the means of paying his present debts.' The expression 'present debts' must have been a reference to the debts of the debtor at the date of the deed or other

transaction. It cannot have been a reference to debts which that person might possibly incur at some future date."

Applying this principal of the law of fraudulent transfers to the facts of the *Heginbotham* petition, the court held that the transfers of property to the new companies were *bona fide* business arrangements and not a contrivance to defraud creditors. The court further stated, based upon the timing of the counter-claim which ultimately resulted in the petitioner's judgment, that "[t]he petitioner was not a creditor, for the purpose of the 1736 Act, at the time of either transaction."

Therefore, the petitioner was a mere future creditor against whom the respondent could not possibly have had the fraudulent intent necessary to impose transferee liability pursuant to a fraudulent transfer.

#### Persuasive authority

It need hardly be stated that the judicial decisions of the Isle of Man are not binding upon a US (or any other) court. The *Heginbotham* decision is significant to US and other common law persons, however, because the *Statute of Elizabeth* forms the basis not only for the fraudulent transfer

law for the Isle of Man, but also for most of the common law world. On that basis, a well-reasoned judicial interpretation of the *Statute of Elizabeth* and its progeny can serve as persuasive authority in any common law jurisdiction.

This court's reasoning gives further support to the legitimacy of transfers to asset protection trusts as long as the settlor retains sufficient assets to pay his existing and future ascertainable debts.

At a time when asset protection planning is seemingly under attack by an uninformed and self-righteous judiciary, the *Heginbotham* decision demonstrates that a favorable outcome is within arm's reach where the waters are not muddied by the tainted fact patterns present in the most recent cases.

*Gideon Rothschild is a partner with Moses & Singer LLP in New York City. He chairs the Asset Protection Planning Committee of the Real Property and Probate Section of the American Bar Association and concentrates his practice on the fields of estate planning and asset protection. He may be reached at (212) 554-7800. The author acknowledges the assistance of Daniel Rubin, an associate at Moses & Singer LLP in preparing the article.*

## MOSES & SINGER LLP

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Gideon Rothschild, Esq.  
1301 AVENUE OF THE AMERICAS  
NEW YORK, NY 10019-6076  
212.554.7800 FAX: 212.554.7700  
WWW.MOESSINGER.COM