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Warning to Creditors: The Clock Is Ticking

In a case of first impression, the North Carolina Court of Appeals recently held that a creditor's fraudulent conveyance claim was time-barred, even though the creditor did not know about the fraudulent nature of the transfer. The Court of Appeals elected to adopt the minority position held by other courts across the country, which have reviewed when the statute of limitations begins to run on a claim under the Uniform Voidable Transactions Act, formerly known as the Uniform Fraudulent Transfer Act (UFTA).

Byron Saintsing

Byron Saintsing has represented clients in the construction and equipment leasing industries for 30 years in matters including mechanics liens, bond claims, delay claims, warranty disputes and bankruptcy issues. He leads a practice group whose attorneys concentrate in matters of construction law, commercial and business litigation, representation of equipment lessors and commercial creditor bankruptcy.

Smith Debnam Narron Drake Saintsing & Myers, LLP
4601 Six Forks Road, Suite 400
Raleigh, North Carolina 27609

919.250.2000 Phone

bsaintsing@smithdebnamlaw.com
smithdebnamlaw.com

The case of *KB Aircraft Acquisition, LLC v. Jack M. Berry and 585 Goforth Road, LLC ("KB Aircraft")* (790 S.E. 2d 559 (2016)) involved a workout of a distressed aircraft loan. Mr. Berry, a guarantor of the loan, owned a vacation mountain home in North Carolina. The value of the house was substantial, and it was not encumbered by any debt. In 2008, the aircraft loan went into default. The creditor worked with the borrower from 2008 to 2010 to restructure the loan, modifying the loan on four separate occasions in an attempt to give the borrower breathing room to service the loan. Unbeknownst to the lender, Mr. Berry transferred his mountain house to a limited liability company, 585 Goforth Road, LLC, at the beginning of the workout negotiations. The LLC was owned by Mr. Berry and his wife. Mr. Berry would later testify that this mountain house was the sole remaining asset in his name and that he intentionally transferred the mountain house out of his name so that he would have no assets in his name. Each of the modification agreements provided, among other things, there had been no material change in the financial condition of the borrower or the guarantor, Mr. Berry.

The borrower ultimately defaulted after the fourth modification of the loan in 2010. The loan was sold to a new lender. The new lender conducted a title search after it acquired the loan and discovered the transfer. It immediately filed suit against the borrower and the guarantor in Florida on the underlying claims for default on the aircraft loan. Following three years of litigation, the new lender ultimately obtained a judgment in Florida against the borrower and Mr. Berry as the guarantor in excess of $10 million in 2013. The new lender immediately domesticated the Florida judgment in North Carolina and after that, filed a separate action under the UFTA to set aside the conveyance of the mountain house.

The trial court in North Carolina dismissed the case as not being brought in a timely fashion. On appeal, the North Carolina Court of Appeals upheld the dismissal. The Court of Appeals held that a literal reading of the UFTA dictated that the clock started running on the new lender's fraudulent conveyance claim at the time of the transfer of the property. It refused to adopt the reasoning of many other courts across the country, construing the very same statutory language, which ruled that the clock does not start running until the creditor knows about the fraudulent nature of the transfer.

Previously North Carolina's courts had held that the mere recording of a deed which served to transfer real estate was not sufficient to put a creditor on notice that the transfer was fraudulent. However, the Court of Appeals held that those cases were not applicable to the time limitations outlined in the UFTA.

The majority of courts reviewing this issue have ruled that the statute of limitations does not begin to run until the creditor is aware of the fraudulent nature of the transfer.[1] The states or courts adopting the majority rule include Illinois, Hawaii, Pennsylvania, Texas, Utah and the 3rd, 5th, 6th, 7th and 9th federal circuit Courts of Appeals. Several courts have adopted the minority position.[2] The states or court adopting the minority rule include Florida, Delaware and New Mexico. For

a recent comprehensive examination of this issue see Daniel Jouppi, Comment, *Saving No One: Unifying Approaches to the UVTA Savings Clause*, 52 Wake Forest L. Rev. 695 (2017).

After being unsuccessful before the North Carolina Court of Appeals, the new lender in *KB Aircraft* filed a petition for discretionary review with the North Carolina Supreme Court. The petition was allowed. The parties fully briefed the issues and the North Carolina Supreme Court held oral argument in the case. However, the North Carolina Supreme Court ultimately ruled that the petition for discretionary review was improvidently allowed. The result was that the North Carolina Supreme Court did not weigh in on the issue, which left the North Carolina Court of Appeals ruling as the final word.

So, what is the takeaway for creditors who litigate such claims in jurisdictions which have adopted the minority rule, or which have not ruled on the issue? Creditors cannot sit back and wait for their underlying claims to be fully adjudicated before investigating, and if warranted, taking action to set aside suspect conveyances. If they do, they run the risk of "winning the battle but losing the war" by being unable to have fraudulent conveyances of assets set aside in order to collect a judgment they obtain in the underlying action. P

1 *See Workforce Solutions v. Urban Servs. of Am.*, 977 N.E.2d 267, 2012 Ill. App. LEXIS 714 (2012); *Field v. Trust Estate of Kepoikai (In re Maui Indus. Loan & Fin. Co.)*, 454 B.R. 133, 2011 Bankr. LEXIS 1719 (D. Hawaii 2011); *State Farm Mut. Auto. Ins. Co. v. Cordua*, 834 F. Supp. 2d 301, 2011 U.S. Dist. LEXIS 138582 (E.D. Pa. 2011); *Schmidt v. HSC, Inc.*, 136 Haw. 158, 358 P.3d 727 (Hawaii 2015); *Janvey v. Democratic Senatorial Campaign Comm., Inc.*, 712 F.3d 185, 2013 U.S. App. LEXIS 5321 (5th Cir. 2013); and *William A. Graham Co. v. Haughey*, 646 F.3d 138, 2011 U.S. App. LEXIS 9906 (3rd Cir. 2011); *Duran v. Henderson*, 71 S.W.3d 833, 2002 Tex. App. LEXIS 1394, *rehearing overruled*, 2002 Tex. App. LEXIS 1968 (2002); *Freitag v. McGhie*, 133 Wn.2d 816, 947 P.2d 1186 (1997); *Rappleye v. Rappleye*, 2004 Ut. App. 290, 99 P.3d 348, *cert. denied*, 106 P.3d 743, 2004 Utah LEXIS 261 (2004); *Belfance v. Bushey (In re Bushey)*, 210 B.R. 95 (B.A.P. 6th Cir. 1997); *Fidelity Nat'l Title Ins. Co. v. Howard Savings Bank*, 436 F.3d 836, 839 (7th Cir. 2006); *Ezra v. Seror (In re Ezra)*, 537 B.R. 924 (B.A.P. 9th Cir. 2015).

2 *MTLC Inv., Ltd.*, 2004 U.S. Dist. LEXIS 31985 (MDFL 2004); *Fitness Quest Inc. v. Monti*, 2012 U.S. Dist. LEXIS 116867 (NDOH 2012); *Pereyron v. Leon Constantin Consulting, Inc.*, 2004 Del. Ch. LEXIS 46 (Del Ch. 2004); *Montoya v. Tobey (In re: Ewbank)* 359 B.R. 807 (Bankr. D. N.M. 2007); *Gulf Ins. Co. v. Clark* 20 P.3d 780 (Mont. 2001); *National Auto Serv. Ctrs., Inc. v. F/R 550, LLC*, 192 So.3d 498 (Fla. Dist. Ct. App. 2016).