Voidable Gift Transfers

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It is not unusual to have an interest in real property conveyed as a gift. This often happens in the context of an inter-spousal transfer that is other than a conveyance pursuant to a judicially sanctioned marital separation or divorce. A conveying spouse may transfer title to insulate the marital residence from the reach of existing or anticipated creditors when, for example, a new business venture is being undertaken. Estate planning may be the motivation for the transfer. The common thread is that the transfer between spouses is a gift for no consideration, other than the outstanding balance on an existing mortgage, or for a nominal consideration. A transfer stemming from a marital proceeding should generally be deemed a for consideration transfer.

Wallach v. Altmeyer, a case recently decided by the United States Bankruptcy Court for the Western District of New York, and reported at 2001 Bankr. LEXIS 1603, highlights the value of title insurance in those instances where there may have been a prior inter-spousal transfer for no consideration or for a nominal consideration. In this case, title to property in Kenmore, Erie County, New York was held by Frank and Sandra Altmeyer, as tenants by the entirety, subject to a mortgage of the Ulster Savings Bank. Frank applied for a mortgage loan from the Centex Home Equity Corporation ("Centex") to refinance the existing mortgage and to obtain additional funds. Frank being the sole name on the loan commitment, Sandra conveyed her interest in the property to her husband at the loan closing by a quitclaim deed reciting a nominal consideration of "one and no more dollars". Frank executed the new mortgage and the existing lien was discharged.

Unfortunately, Sandra was insolvent when she executed the quitclaim deed. Within one year Sandra filed a petition for relief under Chapter 7 of the Bankruptcy Code. The Trustee in Bankruptcy commenced an adversary proceeding to void the transfer of Sandra's interest in the property to Frank and also to void the Centex mortgage to the extent of Sandra's equity in the property immediately prior to execution of the quitclaim deed.

The Bankruptcy Court held that the transfer from the Debtor to her husband was a fraudulent conveyance and the trustee could avoid (or rescind) that transfer. The court also held that Centex did not acquire its mortgage in good faith and without knowledge that the deed to Frank was avoidable. Its mortgage was therefore also avoided to the extent of Sandra's equity in the property when she conveyed her interest to her husband. Upon any sale of the property, the proceeds would be charged with an amount representing the proceeds of the Centex mortgage used to pay off the pre-existing mortgage. One-half of the net balance would be deemed an asset of Sandra's estate free of the lien of the Centex mortgage. The other half of the net balance of the proceeds would be attributable to Frank's interest in the property and be payable to Centex.

In so holding, the court applied provisions of the Bankruptcy Code. First, it found that since Sandra did not receive "reasonably equivalent value" for the transfer of her interest and was insolvent when she conveyed her interest, the deed to her husband was a "fraudulent transfer" under Section 548(a) [2] of the Bankruptcy Code, which provides as follows:

(a) (1) the trustee may avoid any transfer… of an interest of the debtor in property, or any obligation…
incurred by the debtor, that was made or incurred on or within one year before the date of the
filing of the petition, if the debtor voluntarily or involuntarily…

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became
insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for
which any property remaining with the debtor was an unreasonably small capital:

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's
ability to pay or such debts matures….. (2)

The court also held that the Centex mortgage could be avoided to the extent of Sandra's equity in the property when she conveyed her interest to her husband. Bankruptcy Code Section 550(a) provides that a trustee in bankruptcy may recover for the benefit of the debtor's estate the property transferred, or if ordered by the court its value, from:

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

This is limited by Code Section 550(b) that provides the trustee may not recover property or its value from:

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

In this case, the bank's local counsel prepared the nominal consideration deed from Sandra to Frank. Accordingly, the court found that Centex, being on notice that the deed to its mortgagor was for a nominal consideration, was obligated to inquire about the financial solvency of Sandra. Not having done so, Centex did not take its interest as mortgagee in good faith and without knowledge that the deed to Frank could be avoided. The bank's mortgage was subject to avoidance under Code Section 550(a).

Even if counsel engaged to represent the lender had not prepared the deed, the court indicated that it and all persons transacting in real property are charged with the obligation to inquire as to financial solvency of the grantor of a prior recorded conveyance made for no consideration or a nominal consideration. While abstracts are available for review when conveyancing in Erie County, the Court cited text from a 1872 opinion of the Court of Appeals that "a purchaser of land is chargeable with notice, by implication, of every fact affecting the title, which would be discovered by an examination of the deeds or other muniment of title of his vendor, and of every fact, as to which the purchaser, with reasonable prudence or diligence, ought to become acquainted." [3]

Accordingly, when there is a deed with no prior consideration or for nominal consideration (other than a deed pursuant to a matrimonial action), and no recorded subsequent, intervening for consideration transfer of the same interest, the possibility that the deed may be attacked as a fraudulent transfer must be considered when the deed was executed within the period that the law allows a conveyance to be avoided. As part of that analysis, the grantor's name must be run by the title insurer for bankruptcies, judgments and federal tax liens.

In reviewing the reason such a questionable conveyance was made, and the amount and nature of any returns found on a search of the name of the grantor, it may be determined that the transfer may be subject to an attack as a fraudulent conveyance. In such event, a title insurer must consider whether the grantor of that deed is insolvent and, if it is concluded that the grantor is insolvent, raise an exception for the consequences of an action that may be commenced attacking the transfer as being fraudulent.

Certainly, any bankruptcy or insolvency proceeding, or other action involving any grantor of a conveyance for no consideration or for a nominal consideration coming to the attention of a title insurer due to the filing of a notice of pendency or as a result of another inquiry, will need to be promptly reviewed to see if insurance may be afforded.

At a minimum, according to the Altmeyer Court, an affidavit should be obtained that the grantor of the deed in question was solvent, that his or her remaining assets represent a reasonably adequate capital for any anticipated transactions or business, that he or she did not anticipate incurring debts beyond the affiant's ability to pay, and that the affiant had no intent to hinder, delay, or defraud any entity to which he or she was or would become indebted. According to the Court, Centex could have demonstrated its "good faith" by acting in reliance on such an affidavit from Sandra. This may be sufficient if there are no returns found on a search against the name of the grantor.

Under Bankruptcy Code Section 548, a trustee in bankruptcy can avoid a transfer made within one year of the filing of the bankruptcy petition. In addition, Bankruptcy Code Section 544 (b) provides that the trustee can apply state law in attacking a fraudulent conveyance. Under Section 278 of New York's Debtor and Creditor Law ("fraudulent conveyances") a creditor as to whom a conveyance or obligation is fraudulent under state law can "have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim" except when the property has been conveyed to a "purchaser for fair consideration without knowledge of the fraud at the time of the purchase". Article 10 sets forth types of conveyances that can be avoided. [4]

Applying New York's Civil Practice Laws and Rules Sections 203 ("Method of computing periods of limitations generally") and 213 ("Actions to be commenced within six years") and Article 10 of New York's Debtor and Creditor Law ("Fraudulent conveyances"), an action to avoid a transfer upon the ground of constructive fraud (fraud implied in law when there was no fraudulent intent) must be commenced within six years from the commission of a fraudulent act. In the case of actual fraud, when the six year limitations period has expired, an action to avoid a transfer must be commenced within two years of the date the plaintiff discovers, or could have in the exercise of reasonable diligence discovered, the fraudulent act. [5]

If the title company does not undertake to investigate a no consideration or a nominal consideration deed, or makes an erroneous determination of solvency of the grantor of that transfer, and insures without exception, it assumes the risk for its insured purchaser or mortgagee that the insured interest ownership or mortgagee's interest will be avoided in a bankruptcy or other insolvency proceeding brought against that transferor.

The American Land Title Association Owner's and Loan policies issued in New York contain a "creditor's rights exclusion" which carves out from coverage claims that the transaction being insured is a fraudulent or preferential conveyance or transfer. It does not exclude from coverage a claim that a back chain of title conveyance is fraudulent, absent actions by or undisclosed knowledge of the insured.

While the deed and the mortgage in the Centex case may arguably be parts of an integrated transaction subject to the exclusion, this case involves an unusual state of facts. If, as is more likely the situation [6] , a title insurer insures a mortgage or a deed without exception for the possible insolvency of the grantor of a prior, recorded no consideration or nominal consideration deed, the title company could be obligated under its policy to defend the insured mortgage in any adversary proceeding commenced by the trustee in bankruptcy. In the event the insured mortgage or deed is avoided by the trustee, the title company may be liable for the lender's loss.

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(2) Bankruptcy Code Section 548 (a)(1) provides that a conveyance made with fraudulent intent is a fraudulent conveyance.

(3) Cambridge Valley Bank v. Delano, 48 N.Y. 326, 336 (1872).

(4) Section 373 provides that "every conveyance made by a person who is or will be rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made without a fair consideration". See also Section 273-a (Conveyances by defendants), Section 274 (Conveyances by persons in business), Section 275 (Conveyance by a person about to incur debts), Section 276 (Conveyance made with intent to defraud), and Section 277 (Conveyance of partnership property).

(5) Quadrozzi Concrete Corporation v. Americo Mastroianni, 392 N.Y.S. 2d 687 (2d Department, 1977).

(6) See, for example, Lusting v. Hickey, 1994 Bankr. LEXIS 929 (WDNY, 1994).