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Exempt No More: How New York's Uniform Fraudulent Conveyance Act Threatens Exemptions in Bankruptcy

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HOW NEW YORK'S UNIFORM FRAUDULENT CONVEYANCE ACT THREATENS EXEMPTIONS IN BANKRUPTCY

INTRODUCTION

Imagine you are living in western New York. You have a house that you own free and clear.[1] However, in the past, you had some money troubles and one of your creditors has filed a lawsuit against you seeking payment of the debt. In the meantime, you get married and transfer a one-half interest in the house to your spouse. A few years later, you lose your job, and there is no way you are going to be able to pay off your debts. In the face of mounting bills and no regular income, you decide the best course is to file for bankruptcy. You meet with a lawyer and go over your finances. The house is only worth around $70,000 so it is exempt under New York law—that is, it cannot be taken by creditors to satisfy a judgment or sold during bankruptcy.[2] The lawyer tells you that you will be able to keep the house and get a fresh start. After all, that is what bankruptcy is designed to do.

But there is a problem. After you file, the trustee alleges that the transfer of the one-half interest to your spouse was fraudulent under New York law.[3] As a result, the trustee can avoid the transfer and pull that one-half interest into the estate.[4] Even worse, once the interest has been pulled back into the estate, the house is no longer exempt.[5] Now the house can be sold by the trustee, leaving you and your spouse homeless.

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1 That is, not subject to any mortgages or liens.

2 N.Y. C.P.L.R. § 5206 (McKinney 2012).

3 N.Y. DEBT. & CRED. LAW § 273-a (McKinney 2012).

4 11 U.S.C. §§ 544(b), 551 (2013).

5 11 U.S.C. §§ 522(g), 550, 551. Sections 550 and 551 provide that property recovered by the trustee in an avoidance action is preserved for the benefit of the estate. Section 522(g) makes it clear that such property is no longer subject to exemption by providing that certain types of property may still be exempted under certain circumstances. *See, e.g.*, *Hitt v. Glass, (In re Glass)*, 164 B.R. 759, 764-65 (B.A.P. 9th Cir. 1994) *aff'd*, 60 F.3d 565 (9th Cir. 1995).

The Bankruptcy Court for the Western District of New York recently came to this conclusion in *In re Panepinto*.[6] In facts largely similar to the hypothetical case outlined above, the court held that a transfer of exempt property could be constructively fraudulent under New York law and, after the trustee avoided the transfer, the property was no longer exempt.[7]

In most states, this would not happen. The result in *Panepinto* is due to the fact that New York continues to use the outdated Uniform Fraudulent Conveyance Act (UFCA).[8] The vast majority of states have adopted the more modern Uniform Fraudulent Transfer Act (UFTA).[9] The UFTA defines "transfer" to exclude exempt property.[10] However, the UFCA, and New York's version of it, do not.[11] According to the *Panepinto* court, under New York law, a transfer of property can be fraudulent as to the transferor's creditors regardless of the property's exempt status.[12] In the past, this particular quirk of the law may not have received much attention because New York only allowed a modest homestead exemption.[13] However, because the homestead exemption was subsequently increased, the amount of money at stake is now much greater making this an issue worth litigating.[14]

Fraudulent transfer law is designed to protect creditors by preventing debtors from hiding property that can and should be used to satisfy debts.[15] At the most basic level, it allows creditors to recover property and undo transfers that debtors make in an attempt to hinder, delay, or defraud their creditors. However, when a debtor transfers exempt property, no creditor is harmed. Regardless of the transfer, creditors had no right to the property in the first place. Allowing the fraudulent transfer laws

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6 *In re* Panepinto, 487 B.R. 370 (Bankr. W.D.N.Y. 2013).

7 *See id.* at 374-75.

8 *See Uniform Fraudulent Conveyance Act*, PRACTICAL LAW, http://us.practicallaw.com/9-382-3892 (last visited Jan. 18, 2015).

9 *See* UNIF. FRAUDULENT TRANSFER ACT, references & annots (1984), *available at* http://www.uniformlaws.org/shared/docs/fraudulent%20transfer/UFTA_Final_1984.pdf. Forty-three states as well as the District of Columbia and the Virgin Islands have adopted the UFTA. *Id.*

10 UNIF. FRAUDULENT TRANSFER ACT § 1.

11 N.Y. DEBT. & CRED. LAW § 270 (McKinney 2012).

12 *Panepinto*, 487 B.R. at 371.

13 Until 2005, New York only allowed debtors to exempt $10,000 worth of real property used as a primary residence. The current amount ranges from $75,000 to $150,000 depending on county of residence. *See id.* The exemptions are found in New York Civil Practice Law and Rules section 5206 and are made applicable to bankruptcy by New York Debtor & Creditor Law sections 282-284. N.Y. C.P.L.R. § 5206 (McKinney 2012); N.Y. DEBT. & CRED. LAW §§ 282-284.

14 *Panepinto*, 487 B.R. at 374.

15 *See generally* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985).

to reach exempt property does not rectify a wrong; it commits one. Extending fraudulent transfer law to such transfers allows creditors to reach property they have no right to simply because the debtor was not aware of the implications of the transfer.

The National Conference of Commissioners on Uniform State Laws' (the Conference) recently released version of the UFTA provides an excellent framework to guide New York in updating its fraudulent transfer law.[16] In addition to protecting transfers of exempt assets, the new version modernizes and updates fraudulent transfer law. The revisions seek to do away with the confusing labels of "constructive fraud" and "actual fraud."[17] This is an important modernization of the law given that much of what is currently covered by fraudulent transfer law does not require any fraudulent intent at all. The new Act would replace "fraudulent" with "voidable" and help eliminate confusion around interpretation of the law.[18]

This Note will examine the decision in *Panepinto* and argue that it is time for New York to adopt the UFTA. In Part I, the Note will briefly explain the history and purposes behind both the homestead exemption and fraudulent transfer law. This part will also discuss the interaction between state fraudulent transfer law and the federal Bankruptcy Code. Part II will examine *Panepinto* in depth and compare it to a similar case in a jurisdiction that has adopted the UFTA. Part III will establish that there is no basis in current law for reversing the decision in *Panepinto* and will advocate that the New York legislature adopt the newest version of the UFTA.

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[16] NAT'L CONF. OF COMM'RS ON UNIF. STATE LAWS, UNIF. VOIDABLE TRANSACTIONS ACT (formerly THE UNIF. FRAUDULENT TRANSFER ACT) (as amended in 2014), *available at* http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2014AM_AUVTA_Draft_As%20approved.pdf.

[17] Actual fraud is based on intentional deception. 37 AM. JUR. 2D *Fraud and Deceit* § 8 (2014). Constructive fraud is based on specific, legally defined actions which are presumed fraudulent regardless of the actor's intent. *Id.* at § 9. This means that a person can technically be guilty of "fraud" without having any real intent to deceive whatsoever. In light of the common understanding of the word "fraud," applying that label to transfers where there is no intent to deceive can be confusing.

[18] NAT'L CONF. OF COMM'RS ON UNIF. STATE LAWS, AMENDMENTS TO UNIF. FRAUDULENT TRANSFER ACT reporter's introductory note (2013), *available at* http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013AM_AUFTA_Draft.pdf.

I. HOMESTEAD EXEMPTIONS AND FRAUDULENT TRANSFERS

A. *History and Purpose of Homestead Exemptions*

American homestead exemption laws originated in Texas in the 1830s.[19] The laws generally exempt a portion or all of the value of a debtor's home from being used to satisfy judgments against the debtor. Currently, most states as well as the Bankruptcy Code have some form of homestead exemption.[20] The purpose "of homestead exemption laws is to protect home equity, preserve home ownership, avoid the eviction of families, and minimize the need for public welfare and housing assistance."[21]

These exemptions represent a balancing act between enforcing credit agreements and ensuring that debtors do not end up as wards of the state.[22] Enforcing the right of lenders and other creditors to paid is important to ensure an adequate supply of credit, but "the social cost of leaving a debtor and his family without resources may outweigh the economic disadvantages of immunizing property from the claims of creditors."[23]

State-level homestead exemptions generally work to prevent a judgment creditor from forcing a sale of the debtor's home to satisfy the judgment.[24] Almost all states exempt at least a portion of the debtor's homestead from being used to satisfy money judgments against the owner.[25] These exemptions apply in bankruptcy through 11 U.S.C. § 522(b).[26] That provision generally exempts from the estate "any property that is exempt under . . . State or local law."[27] This mechanism

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[19] George L. Haskins, *Homestead Exemptions*, 63 HARV. L. REV. 1289, 1289 (1950); *see also State Homestead Exemption Laws*, 46 YALE L.J. 1023 (1937).

[20] *See* Haskins, *supra* note 19; 11 U.S.C. § 522(d) (2013).

[21] Timothy R. Tarvin, *Bankruptcy, Relocation, and the Debtor's Dilemma: Preserving Your Homestead Exemption Versus Accepting the New Job Out of State*, 43 LOY. U. CHI. L.J. 141, 144 (2011).

[22] *Bankruptcy Exemptions: Critique and Suggestions*, 68 YALE L.J. 1459, 1459 (1959) [hereinafter *Bankruptcy Exemptions*].

[23] *Id.*

[24] When a party recovers a money judgment in a lawsuit, it becomes a judgment creditor of the debtor. If the debtor does not have sufficient cash to pay the judgment (or refuses to), the judgment creditor can then levy the assets of the debtor and force a sale. The judgment creditor is then paid from the proceeds of the sale. Exemption law, including the homestead exemption, protects certain assets of the debtor from this process. *See generally* 31 AM. JUR. 2D *Exemptions* § 223 (2014); 46 AM. JUR. 2D *Judgments* (2014).

[25] *See, e.g.*, N.Y. C.P.L.R. § 5206 (McKinney 2012); TEX. PROP. CODE ANN. § 41.001 (2001).

[26] 11 U.S.C. § 522(b) (2013).

[27] *Id.* § 522(b)(3)(A). There are some limitations and exceptions both in the Bankruptcy Code and in state law, but the basic starting point is that a debtor in

allows a debtor in bankruptcy to use state exemption laws to protect her property from being liquidated to pay creditors.[28]

One of the central features of bankruptcy law is the ability to provide the "honest but unfortunate debtor" a "fresh start."[29] Saving the debtor's home is often central to the debtor's potential to rebuild his finances. In addition to the potential loss of equity, individuals without homes often struggle to find jobs.[30] Increasing the number of homeless and jobless people puts stress on the social system and drains resources from the state. Allowing debtors to retain their homes promotes the goal of giving honest but unfortunate debtors a fresh start. While there are costs associated with exempting what is typically a debtor's largest asset from execution, the costs of evicting everyone who cannot pay their debts and leaving them out on the street can more than outweigh the costs to the credit system.[31] Absent exemptions, debtors may be forced to rely on public assistance, which means the state will have to raise additional taxes or divert revenue from other sources.

Homestead exemptions also represent a policy choice by lawmakers to protect "the security of the family" which "prevents pauperism and provides the members of the family with some measure of stability and independence."[32] As one court put it, "preservation of the home is deemed of paramount importance."[33] In addition to providing economic advantages to the debtor, home ownership is of public value as it is thought to connect people to their communities and "cultivate the interest, pride, and affection of the individual, so essential to the stability and prosperity of government."[34] Since the legislature has

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bankruptcy can exempt whatever property that state law exempts from being used to satisfy judgments.

28 *Id.* § 522(b). Federal law also contains a homestead exemption for bankruptcy. Under 11 U.S.C. § 522(d)(1), a debtor can currently exempt up to $22,975 of his or her aggregate interest in property that the debtor uses as a residence. Generally speaking, a debtor can elect to use either the federal or state exemption scheme. Note that exemption values (and many other dollar amounts) in the Bankruptcy Code are periodically adjusted for inflation under 11 U.S.C. § 104. This note uses the dollar values in effect as of the year 2014.

29 Grogan v. Garner, 498 U.S. 279, 286-87 (1991).

30 *See* Christine Schanes, *Homelessness Myth #1: "Get a Job!"*, HUFFINGTON POST (June 13, 2010, 11:22 PM), http://www.huffingtonpost.com/christine-schanes/homelessness-myth-1-get-a_b_339500.html.

31 *Bankruptcy Exemptions*, *supra* note 22, at 1459.

32 Haskins, *supra* note 19, at 1289.

33 *In re* Estate of Dodge, 685 P.2d 260, 263 (Colo. App. 1984).

34 *Id.*; *see also* Ferguson v. Kumler, 6 N.W. 618, 619 (Minn. 1880) ("The [homestead exemption] originated in the wise and humane policy of securing to the citizen against all the misfortunes and uncertainties of life the benefits of a home not in the interest of [the homeowner] alone, but likewise in the interest of the state, whose welfare and prosperity so largely depend upon the growth and cultivation among its citizens of feelings of personal independence, together with love of country and

chosen to enact a policy of protecting the home through the exemption laws, these laws "should be liberally construed so as to carry out the legislative intent."[35]

B. History and Purpose of Fraudulent Transfer Laws

Fraudulent transfer law, in its most basic form, allows a creditor to avoid transfers made by a debtor that were intended to hinder, delay, or defraud creditors.[36] In short, a debtor should not be able to avoid paying his or her debts by transferring property to a friend only to reclaim it after the creditors have settled with the debtor or given up. These laws can be traced back to sixteenth century English common law and the 1571 Statute of Fraudulent Conveyances.[37] England at the time "had certain sanctuaries into which the King's writ could not enter."[38] Creditors could not go after a debtor taking refuge in a sanctuary.[39] If the debtor no longer held any property, the creditors were left without recourse and would often settle their claims for a relatively small amount.[40]

The Statute of Fraudulent Conveyances made "illegal and void any transfer made for the purpose of hindering, delaying, or defrauding creditors."[41] The basic structure, to hinder, delay, or defraud creditors, survives in almost all modern fraudulent transfer law.[42] However, the subjective intent of the debtor is difficult to prove.[43] To decide which transfers are intended to hinder, delay, or defraud, courts generally have to rely on circumstantial evidence to infer the debtor's motives.

To address these difficulties, courts have developed a series of factors that can be used as circumstantial evidence of

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kindred-sentiments that find their deepest root and best nourishment where the home life is spent and enjoyed.").

[35] *Ferguson*, 6 N.W. at 619.

[36] Baird & Jackson, *supra* note 15, at 829.

[37] 1 GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 58 (1940).

[38] *Id.* at § 61.

[39] *Id.*

[40] *Id.* While the Statute of Fraudulent Conveyances is often cited as being designed to prevent this practice, that is not the whole story. There existed at the time common law that allowed creditors to go after the assets of debtors who had taken sanctuary. For more on this, see *id.* at §§ 58-61e.

[41] Baird & Jackson, *supra* note 15, at 829.

[42] Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531, 537 (1987) [hereinafter Kennedy, *Involuntary*].

[43] Frank R. Kennedy, *The Uniform Fraudulent Transfer Act*, 18 UCC L.J. 195, 196 (1986) [hereinafter Kennedy, *UFTA*].

fraudulent intent, often referred to as the badges of fraud.[44] Applying these badges, the court can presume fraudulent intent if certain conditions are met without regard to the actual intent of the transferor.[45] One of the historic badges is a transfer of property by an insolvent debtor without fair compensation.[46] This particular badge was codified in the UFCA and made a part of the laws of the states that adopted it.[47] No showing of intent is required.[48] If the conditions are met, the transfer may be avoided.[49] This is typically referred to as constructive fraud.[50] It is suggested that the drafters of the UFCA specifically intended the law to capture transfers made by insolvent debtors for less than fair value even if there was no intent to hinder, delay, or defraud creditors.[51] The law treats the transfer as fraudulent to the debtor's creditors regardless of the debtor's actual motive.

New York adopted the UFCA in 1925.[52] The Act is currently codified in New York Debtor & Creditor Law (NYDCL) sections 270, *et seq.*[53] The relevant provisions are the constructive fraud provisions in sections 273 to 275. These provisions apply "without regard to [the] actual intent" of the transferor.[54] Any

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[44] Baird & Jackson, *supra* note 15, at 830 (citations omitted); Philco Fin. Corp. v. Pearson, 335 F. Supp. 33, 40-41 (N.D. Miss. 1971). Badges of fraud include:

> (1) the lack or inadequacy of consideration;
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> (2) the family, friendship or close associate relationship between the parties;
>
> (3) the retention of possession, benefit or use of the property in question;
>
> (4) the financial condition of the party sought to be charged both before and after the transaction in question;
>
> (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and
>
> (6) the general chronology of the events and transactions under inquiry

Salomon v. Kaiser (*In re* Kaiser), 722 F.2d 1574, 1582-83 (2d Cir. 1983).

[45] Kennedy, *Involuntary*, *supra* note 42, at 537-38.

[46] *See* Baird & Jackson, *supra* note 15, at 830.

[47] 11 U.S.C. § 548(a)(1)(B) (2013); N.Y. DEBT. & CRED. LAW § 273 (McKinney 2012); UNIF. FRAUDULENT TRANSFER ACT § 5(a) (1984), *available at* http://www.uniformlaws.org/shared/docs/fraudulent%20transfer/UFTA_Final_1984.pdf; UNIF. FRAUDULENT CONVEYANCE ACT § 4 (1918).

[48] N.Y. DEBT. & CRED. LAW § 273 ("Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors *without regard to his actual intent* if the conveyance is made or the obligation is incurred without a fair consideration.") (emphasis added).

[49] *See* Sklaroff v. Rosenberg, 125 F. Supp. 2d 67, 74 (S.D.N.Y. 2000), *aff'd*, 18 F. App'x 28 (2d Cir. 2001). .

[50] *See* 37 AM. JUR. 2D *Fraud and Deceit* § 9 (2014).

[51] Baird & Jackson, *supra* note 15, at 831-32.

[52] GLENN, *supra* note 37, at § 62 n.73.

[53] *See* HBE Leasing Corp. v. Frank, 48 F.3d 623, 633 (2d Cir. 1995).

[54] N.Y. DEBT. & CRED. LAW §§ 273-274 (McKinney 2012).

conveyance made that meets the requirements of sections 273 to 275 can be deemed fraudulent without any showing that the debtor intended to hinder, delay, or defraud his or her creditors.[55] Once such a conveyance is deemed fraudulent, the creditors can have the conveyance annulled, set aside, or directly levy on the property as if the conveyance never happened.[56]

To understand the issues raised in *Panepinto*, it is important to look in detail at some sections of New York's UFCA, particularly sections 270 to 273-a.[57] Section 273 makes fraudulent any conveyance made without fair consideration by a person who is insolvent or is made insolvent by the conveyance.[58] Section 271 defines a person as insolvent "when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."[59] Section 273-a makes fraudulent any conveyance made without fair consideration by a person who is a defendant in an action for money damages if the final judgment is not paid.[60]

To avoid a transfer under sections 273 and 273-a, the party seeking to avoid the transfer must show that the transferor did not receive fair consideration.[61] Section 272 defines fair consideration as receiving property that is a fair equivalent to the property transferred or the satisfaction of an antecedent debt.[62] It can also include an exchange that is not equivalent so long as it is not "disproportionately small as compared with the value of the property, or obligation obtained."[63] Section 270 also contains some important definitions. First, a "'[c]onveyance' includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any

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[55] *See* Paradigm BioDevices, Inc. v. Viscogliosi Bros., LLC, 842 F. Supp. 2d 661, 666 (S.D.N.Y. 2012); *see also* Julien J. Studley, Inc. v. Lefrak, 412 N.Y.S.2d 901, 905 (App. Div. 1979), *aff'd*, 401 N.E.2d 187 (N.Y. 1979).

[56] N.Y. DEBT. & CRED. LAW § 278.

[57] *In re* Panepinto, 487 B.R. 370, 372 (Bankr. W.D.N.Y. 2013). The court only discusses constructive fraud in relation to section 273-a, but the creditors raised both sections 273 and 273-a in their motion. Further, the analysis the court uses could apply equally to any of the constructive fraud provisions found in sections 273-275. For purposes of this note, I will focus only on sections 273 and 273-a. Sections 270-272 supply important definitions that are referenced in §§ 273 and 273-a.

[58] N.Y. DEBT. & CRED. LAW § 273.

[59] *Id.* § 271.

[60] *Id.* § 273-a.

[61] *Id.* §§ 273 & 273-a.

[62] *Id.* § 272(a).

[63] *Id.* § 272(b).

lien or incumbrance."[64] Second, "'assets' of a debtor means property not exempt from liability for his debts."[65]

In summary, the essential rules are: (1) a transfer made for no consideration while a person is insolvent or a defendant in a lawsuit can be deemed fraudulent without any intent on the part of the debtor to hinder, delay, or defraud her creditors and; (2) the word "conveyance" as used in these statutes covers any type of property including property that would normally be exempt from execution by creditors. Taken together, these points mean that a creditor could technically seek the avoidance of a conveyance of property even though the property cannot be used to satisfy the debtor's obligation. However, there is little incentive to seek avoidance in such a case because even if the conveyance is set aside or annulled, the creditor still cannot levy on the property.[66] In this situation, returning the property to the debtor does not help the creditor's position at all. This all changes once we add the Bankruptcy Code into the mix.

C. How State Fraudulent Conveyance Law Interacts with the Bankruptcy Code

The Bankruptcy Code has its own fraudulent conveyance provisions, namely 11 U.S.C. §§ 547 and 548. Section 547 covers preferential payments[67] and § 548 mirrors the core provisions of the UFCA but vests the power to avoid fraudulent transfers in the trustee rather than the creditors.[68]

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[64] *Id.* § 270.

[65] *Id.*

[66] *See* Corbin v. Litke, 431 N.Y.S.2d 800, 802 (N.Y. Sup. Ct. 1980) (holding that homestead exemption would still apply after avoidance of transfer).

[67] In general, a preference is a payment made by a debtor, while insolvent, on account of an antecedent debt, to a creditor within 90 days of the debtor filing for bankruptcy. For more information, see generally Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3 (1986) and Vern Countryman, *The Concept of A Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713 (1985).

[68] 11 U.S.C. § 548(a)(1) (2013) provides that:

> The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
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> (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

In addition to these specific avoidance statutes, the trustee can also take advantage of the relevant state-level fraudulent transfer law through § 544. That section generally gives the trustee the power to avoid any transfer that a creditor of the debtor could avoid under applicable law.[69] In New York, this would include NYDCL sections 273 and 273-a.

Assuming the trustee avoids the transfer of exempt property under one of these provisions, what happens next? As noted above, the likely result under state law outside of bankruptcy would be that the creditor is still prevented from going after the exempt property.[70] However, that is not the result under the Bankruptcy Code. Under 11 U.S.C. §§ 551 and 522(g), the exempt property will not only return to the estate but will also lose its exempt status.[71] Section 551 simply states that any property recovered through an avoidance action in bankruptcy becomes property of the estate.[72] Once the property is back in the estate, § 522(g) ensures that the exemption no longer applies.[73] So long as the transfer was voluntary, the

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> (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (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 as such debts matured; or
>
> (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548(a)(1).

[69] 11 U.S.C. § 544(b)(1) ("[T]he trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.").

[70] *See Corbin*, 431 N.Y.S.2d at 802. In this case the creditors successfully avoided a conveyance of real estate between husband and wife as fraudulent, but the court stated that the defendants would be entitled to the full statutory homestead exemption if the property was properly designated as a homestead. *Id.*

[71] Hitt v. Glass (*In re* Glass), 164 B.R. 759, 764 (B.A.P. 9th Cir. 1994), *aff'd*, 60 F.3d 565 (9th Cir. 1995) ("The purpose of § 522(g) is to prevent a debtor from claiming an exemption in recovered property which was transferred in a manner giving rise to the trustee's avoiding powers, where the transfer was voluntary or where the transfer or property interest was concealed.").

[72] 11 U.S.C. § 551 ("Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.").

[73] 11 U.S.C. § 522(g).

estate gets the benefit of the recovered property regardless of its exemption status.

Thus, under a state law action, even if a creditor can avoid a transfer as fraudulent, the debtor is still entitled to the statutory exemptions. However, because of §§ 551 and 522(g) of the Bankruptcy Code, when a trustee does the same thing in bankruptcy, the debtor is no longer entitled to claim exemptions in the property. To illustrate this problem, we now turn to *Panepinto*.

II THE UFCA AND THE UFTA IN ACTION

A. UFCA: Panepinto

Panepinto was originally filed as a chapter 7 liquidation case on April 23, 2012.[74] It was later converted to a chapter 13 case on July 17, 2012, and the debtor filed a plan under 11 U.S.C. § 1322.[75] The debtor listed her residence, a home she owned jointly with her husband, as an exempt homestead under New York Civil Practice Law and Rules (NYCPLR) section 5206. However, the debtor originally owned the home by herself, free and clear of any liens. In 2008, she transferred an ownership interest to her husband, and since that time, they held the house jointly as tenants in the entirety. At the time the transfer was

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> (g) Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if—
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> (1)(A) such transfer was not a voluntary transfer of such property by the debtor; and
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> (B) the debtor did not conceal such property; or
>
> (2) the debtor could have avoided such transfer under subsection (f)(1)(B) of this section.

Id.

[74] *See* Docket, *In re* Panepinto, 487 B.R. 370 (Bankr. W.D.N.Y. 2013) (No. 12-11230) [hereinafter *Panepinto* Docket].

[75] *See id.* In a Chapter 13 case, the debtor is required to file a plan that meets the requirements of 11 U.S.C. §§ 1322 & 1325. Unlike a Chapter 7 liquidation case where a debtor surrenders all non-exempt property but keeps his or her future income, a Chapter 13 case generally allows a debtor to keep all of his or her assets while pledging to pay creditors from future income. The plan details the terms of those future payments and, in general, must provide for payments to creditors that at least equal what the creditors would have received in a Chapter 7 liquidation. *See generally* 9 AM. JUR. 2D §§ 68, 72 *Bankruptcy*.

made, the debtor was the defendant in an action seeking a money judgment filed by Target National Bank.[76]

After the debtor filed her chapter 13 plan, two of the creditors objected to the plan arguing, inter alia, that the transfer of the ownership interest to the debtor's husband was fraudulent under both NYDCL sections 273 and 273-a.[77] The transfer could be held fraudulent under section 273 because New York law presumes the debtor is insolvent when the transfer is voluntary and the debtor does not receive fair consideration.[78] The transfer could also be fraudulent under section 273-a because, at the time of the transfer, the debtor was a defendant in an action for monetary damages and had not paid the final judgment.[79]

The debtor filed a motion to dismiss the objections arguing, inter alia, that the transfer was not fraudulent because the interest transferred was subject to state exemption law.[80] The creditors argued that New York's version of the UFCA defines "conveyance" as any "payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property," and the term "property" includes exempt property.[81] The court agreed with the creditors. It noted that, despite the many cases from other states that held differently, under New York law the transfer could be avoided.[82] The court attributed the inconsistency to the fact that New York still uses the UFCA while nearly every other state has adopted the UFTA. Both the UFTA and the UFCA define "asset" to exclude exempt property of the debtor.[83] However, the UFTA defines "transfer" as disposing or parting with an "*asset*" and

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[76] Objections Pursuant to 11 U.S.C. 1325 and Bankruptcy Rules 3020[,] 11 U.S.C. 522(l) and Bankruptcy Rules 4003, Opposition to Debtor's Motion Pursuant to 11 U.S.C. 522(f) at ¶ 1.e, *In re* Panepinto, 487 B.R. 370 (Bankr. W.D.N.Y. 2013) (No. 12-11230-MJK) [hereinafter: *Creditor's Objections*].

[77] *Id.* at ¶ 1.

[78] Hassett v. Far West Fed. Sav. & Loan Assoc. (*In re* O.P.M. Leasing Servs., Inc.), 40 B.R. 380, 393 (Bankr. S.D.N.Y. 1984), *aff'd*, 44 B.R. 1023 (S.D.N.Y. 1984). The debtor in *Panepinto* raised the issue of consideration in her motion to dismiss the objections. Debtor's Response to Creditors' Objections Together with Motion to Dismiss Objections at ¶ 17, *In re* Panepinto, 487 B.R. 370 (Bankr. W.D.N.Y. 2013) [hereinafter *Debtor's Response*]. However, the judge did not address this issue when ruling on the motion and the objections and focused instead on section 273-a. *Panpeinto*, 487 B.R. at 372. It is undisputed that the debtor was involved in a lawsuit at the time of the transfer and had not paid the judgment so this issue was easier to address. *Creditor's Objections*, *supra* note 76, at ¶ 1(e).

[79] N.Y. DEBT. & CRED. LAW § 273-a (McKinney 2012).

[80] *Debtor's Response*, *supra* note 78.

[81] N.Y. DEBT. & CRED. LAW § 270.

[82] *Panepinto*, 487 B.R. at 374.

[83] *See* UNIF. FRAUDULENT TRANSFER ACT § 1 (1984); *see also* N.Y. DEBT. & CRED. LAW § 270.

not "*property*."[84] Therefore, a transfer of exempt property, by definition, cannot be fraudulent under the UFTA but can be fraudulent under the UFCA. The court also stated that the provisions of 11 U.S.C. §§ 551 and 522(g) would work to eliminate the exemptions the property might be protected by once the transfer was avoided.[85]

It should be noted that the ruling in *Panepinto* did not conclusively decide the case.[86] At this point, no party had filed an adversary proceeding seeking to avoid the transfer.[87] The issue was raised in the context of an objection to the debtor's chapter 13 plan and the debtor's motion to dismiss those objections.[88] In ruling on these motions, the court simply denied the debtor's motion to dismiss the objections, sustained the objections of the creditors, and declined to confirm the plan without prejudice.[89] The court did rule that, as a matter of law, the transfer in this case *could* be avoided, and that if it was, the debtor would not be entitled to an exemption.[90] However, because there was no adversary proceeding before the court seeking to avoid the transfer, the court did not rule that the transfer would be avoided at that time.[91]

In making this ruling, the court explicitly drew a distinction between states that adopted the UFTA and ones that still use the UFCA.[92] The court noted that many courts in different states had held that a transfer of exempt property was not fraudulent.[93] However, the court stated that the language of the UFCA compelled a different result.[94] The court went on to make it clear that the sole basis for its ruling was the difference in language.[95] In a state that has adopted the UFTA, this would not happen.

B. UFTA: In re Blanch

As the *Panepinto* court noted, there is a significant difference between the terminology in the UFCA and UFTA. In 1979, the Conference decided it was time to update the UFCA

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[84] UNIF. FRAUDULENT TRANSFER ACT § 1(12) (emphasis added).
[85] *Panepinto*, 487 B.R. at 371.
[86] *Id.* at 375.
[87] *See id.* at 374.
[88] *Id.* at 375.
[89] *See id.* at 374-75.
[90] *Id.* at 371.
[91] *Id.* at 374-75.
[92] *Id.* at 373.
[93] *Id.* at 374.
[94] *See id.*
[95] *See id.*

and developed the revised UFTA in 1984.[96] The goal was to update the UFCA to accommodate the various changes in other commercial laws since its promulgation in 1918.[97] Currently, 43 states as well as the District of Columbia and the Virgin Islands have adopted the UFTA.[98] One of the most obvious changes made to the law was the change in terminology from conveyance to transfer. The drafters stated that this change was made because the word "conveyance" is closely associated with real estate transfers, and they wanted to make clear the intent of the UFTA to cover all transfers of property.[99] This change was more profound than the drafters realized at the time.

The case of *In re Blanch*, from the Bankruptcy Court for the Central District of Illinois, is illustrative of this point.[100] The facts of *Blanch* are quite similar to *Panepinto*. The debtor had conveyed his otherwise exempt homestead to his parents approximately two years prior to filing for bankruptcy.[101] After the transfer, he continued to reside there.[102] The trustee brought an action against the debtor's parents to avoid the transfer as fraudulent under Chapter 740 of the Illinois Compiled Statutes sections 160/5 and 160/6.[103] The defendants countered that the transfer was not fraudulent because the property would have been exempt anyway.[104] They pointed out that under Illinois' version of the UFTA, "transfer" as defined in 160/2 is the "disposing of or parting with an *asset*."[105] As the court noted, "asset" does not include "property to the extent it is generally exempt under laws of this State."[106] As a result, the court held that "[p]roperty which is encumbered by a lien or

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96 Kennedy, *UFTA*, *supra* note 43, at 198.

97 *Id.* at 198-99.

98 *See* UNIF. FRAUDULENT TRANSFER ACT, references & annots (1984). Legislation is also pending in several states to adopt the most recent version of the act. *Legislation*, UNIFORM LAW COMMISSION, http://www.uniformlaws.org/Legislation.aspx (last visited Jan. 12, 2015).

99 Kennedy, *UFTA*, *supra* note 43, at 199.

100 *See* Covey v. Blanch (*In re* Blanch), Nos. 97-82652, 98-8011, 1998 WL 34065289 (Bankr. C.D. Ill. Sept. 11, 1998).

101 *Id.*, at *1.

102 *Id.*

103 *Id.* 740 ILL. COMP. STAT. 160/5 contains the main fraudulent transfer language that covers actual fraud (intent to hinder, delay, or defraud) and fraud related to incurring subsequent debts. 106/6 is the constructive fraud provision that allows avoidance of transfers while the debtor was insolvent. 740 ILL. COMP. STAT. 160/5, 160/6 (2014) (similar to N.Y. DEBT. & CRED. LAW § 273 (McKinney 2012)).

104 *Blanch*, 1998 WL 34065289, at *1.

105 740 ILL. COMP. STAT 160/2(l) (emphasis added); *see also Blanch*, 1998 WL 34065289, at *2.

106 *Blanch*, 1998 WL 34065289, at *2 (citing 740 ILL. COMP. STAT. 160/2(b)(2)).

subject to a homestead exemption is not an asset which is subject to recovery as a fraudulent transfer."[107]

Comparing the results of *Panepinto* and *Blanch*, as well as the court's discussion in *Panepinto*, shows that the root of the problem is the difference between the UFCA and the UFTA, at least to the *Panepinto* and *Blanch* courts. The next section will consider whether there are any grounds under existing law to overturn the decision in *Panepinto* and argue that the easiest and best solution to avoid this inconsistency is for New York to adopt the UFTA.

III NEW YORK SHOULD ADOPT THE 2014 UFTA

A. There Are No Grounds Under Existing Law to Overturn This Ruling.

There are two potential, but ultimately unsuccessful, grounds for overturning the decision in *Panepinto*. First, the reviewing court could decide that these types of transfers are subject to the "no harm, no foul" rule. Second, since this case is interpreting state law, there could be precedent from New York courts holding that transfers of exempt property are not fraudulent under state law. However, there is no precedent directly on point from New York courts to guide the federal courts in interpreting this state law issue.

1. The "No harm, No Foul" Rule

As noted in Part I, both fraudulent transfer and exemption law have been part of the American legal system for many years. Some jurisdictions adopted a "no harm, no foul" rule when determining whether to avoid transfers of exempt property.[108] The basic idea behind this rule is that if the property would not have been available to creditors prior to the transfer then the transfer cannot be fraudulent as to the creditors.[109]

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[107] *Id.*, at *2. It is interesting to note that the defendants also cited precedent in Illinois law, some of which predates even the UFCA, that held that transfers of exempt property could not be fraudulent. *Id.* It appears that Illinois was an early adopter of the "no harm, no foul" rule for fraudulent transfers. *See infra* Part III.A.1. However, the court did squarely address the language of the UFTA and held that this language completely protects exempt property from fraudulent transfer law. *Blanch*, 1998 WL 34065289, at *2.

[108] Dana Yankowitz, Comment, *"I Could Have Exempted It Anyway": Can A Trustee Avoid A Debtor's Prepetition Transfer of Exemptible Property?*, 23 EMORY BANKR. DEV. J. 217, 227 (2006); *see also* Jarboe v. Treiber (*In re* Treiber), 92 B.R. 930, 932 (Bankr. N.D. Okla. 1988).

[109] *Treiber*, 92 B.R. at 932.

Illinois is a good example, and the *Blanch* case discussed above provides a good summary of the case law on the issue. As far back as 1880, well before the adoption of the UFCA, the Illinois Supreme Court held that "[n]o conveyance of property exempt from execution can be considered fraudulent as against a creditor."[110] However, for both legal and policy reasons, full embrace of the "no harm, no foul" rule is not a viable option.

For the most part, federal courts have rejected the "no harm, no foul" approach when applying the fraudulent transfer provisions found in the Bankruptcy Code itself. Key examples are the Fourth Circuit's decision in *Tavenner v. Smoot*[111] and the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re Trujillo*.[112] Both cases directly held that a transfer of exempt property under 11 U.S.C. § 548 could be avoided as fraudulent and that § 522(g) prevented the debtors from claiming the property as exempt once the transfer was avoided.[113] Although some bankruptcy courts have explicitly endorsed the "no harm, no foul" rule,[114] the positions taken in *Tavenner* and *Trujillo* represent the current majority position.[115]

Despite this, there is some authority for continuing or even expanding the "no harm, no foul" rule. In 1990, the Supreme Court in *Begier v. I.R.S.* seemed to endorse at least a limited version of the "no harm, no foul" rule as to preferences under 11 U.S.C. § 547.[116] The Court found that "an interest of the debtor in property" for purposes of § 547 only includes "that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings."[117] The Court relied primarily on the policy behind fraudulent transfer law.[118] It stated that the purpose of § 547 was to help insure "[e]quality of distribution among

[110] Leupold v. Krause, 95 Ill. 440, 444 (1880).

[111] Tavenner v. Smoot, 257 F.3d 401 (4th Cir. 2001).

[112] Trujillo v. Grimmet (*In re* Trujillo), 215 B.R. 200 (B.A.P. 9th Cir. 1997), *aff'd*, 166 F.3d 1218 (9th Cir. 1998).

[113] *Tavenner*, 257 F.3d at 406-07; *Trujillo*, 215 B.R. at 204-05 & n.5.

[114] *See, e.g.*, *Treiber*, 92 B.R. at 932 ("No creditor is injured when the entire subject matter of a preference consists of exempt property. If the property had not been conveyed, the creditors would not have shared in it. In short,—no harm, no foul."); Noland v. Turner (*In re* Turner), 45 B.R. 649, 651 (Bankr. S.D. Ohio 1985) ("Thus, it serves no purpose for the Trustee to seek the avoidance of a transfer which removed no non-exempt property from the estate or which does not deplete the estate in some way. Such transfer does not hinder, delay or defraud any creditor, since creditors would not have benefited from the property if there had been no transfer.").

[115] *See* Yankowitz, *supra* note 108, at 219.

[116] Begier v. I.R.S., 496 U.S. 53 (1990).

[117] *Id.* at 58.

[118] *See id.*

creditors."[119] It further stated that "if the debtor transfers property that would not have been available for distribution to his creditors in a bankruptcy proceeding, the policy behind the avoidance power is not implicated."[120]

While *Begier* only covered preferences under § 547, the Southern District of New York in *Bear, Stearns Sec. Corp. v. Gredd* used the language of *Begier* to extend the rule to § 548.[121] That court stated that:

> While *Begier* and its progeny were concerned with § 547 rather than § 548, the "normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning," counsels us to construe this language to have the same meaning when it is used in § 548(a)(1)(A).[122]

The court ultimately concluded that a transfer could only be avoided when the property would have been available to creditors.[123]

Whether this fully protects transfers of exempt property from avoidance under § 548 is not clear. Technically, the property in *Begier* and *Bear Stearns* was never property of the estate to begin with. Exempt property is considered property of the estate until the debtor elects the exemption.[124] The logic of many courts in allowing § 548 to reach transfers of exempt property focuses on this distinction.[125] Prior to the Bankruptcy Reform Act of 1978, which created the modern Bankruptcy Code, property subject to exemption never became property of the estate.[126] Further, the text of § 522(g) seems to endorse the avoidance of transfers of exempt property since it prevents debtors from asserting an exemption on property that has been recovered by the trustee.[127]

The court in *Panepinto* considered whether the holdings in *Begier* and *Bear Stearns* should guide its decision, but

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[119] *Id.*

[120] *Id.*

[121] Bear, Stearns Sec. Corp. v. Gredd (*In re* Gredd), 275 B.R. 190, 193-94 (Bankr. S.D.N.Y. 2002).

[122] *Id.* at 194 (quoting Sullivan v. Stroop, 496 U.S. 478, 484 (1990)).

[123] *Id.* at 196 ("We thus conclude that § 548(a)(1)(A) only permits a trustee to avoid a transfer of an interest of the debtor in property when, but for the transfer, such property interest would have been available to at least one of the debtor's creditors.").

[124] *See* 11 U.S.C. §§ 522(b), 541(a)(1) (2013). All interests of the debtor become property of the estate per § 541 and the debtor is then allowed to exempt certain property out of the estate per 522(b).

[125] *See, e.g.*, Tavenner v. Smoot, 257 F.3d 401, 406 (4th Cir. 2001).

[126] Lasich v. Wickstrom (*In re* Wickstrom), 113 B.R. 339, 347 n.10 (Bankr. W.D. Mich. 1990).

[127] *See* 11 U.S.C. § 522(g); *see also* Trujillo v. Grimmet (*In re* Trujillo), 215 B.R. 200, 205 & n.5 (B.A.P. 9th Cir. 1997).

ultimately decided that the precedents did not apply because the provision at stake was § 544, not §§ 547 or 548.[128] However, the crux of the determinations in *Begier* and its progeny and *Bear Stearns* was the definition of "an interest of the debtor in property."[129] Those courts held that "an interest of the debtor in property" did not encompass property that would not otherwise be available for creditors.[130] Section 544 uses the same phrase, "an interest of the debtor in property."[131] The court in *Bear Stearns* based its extension of *Begier* to § 548 in part on the concept that "the 'normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning.'"[132] Since § 544 uses identical words, the same principles that apply to "an interest of the debtor in property" in §§ 547 and 548 should also apply to § 544.

To justify its decision not to extend *Begier* and *Bear Stearns*, the *Panepinto* court stated that the maximum two year "look back" period of §§ 547 and 548 indicates that the focus is on the "slide into bankruptcy" and courts are thus more concerned with the "impact of pre-petition transfers [on] the . . . bankruptcy estate."[133] The court stated that "§ 544 is different[,]" but did not elaborate.[134] But, even if the court decided that § 544 should be treated the same as §§ 547 and 548, *Begier* and *Bear Stearns* are still not applicable because they dealt with an entirely different type of property. In both cases the property in question was property that would not have been part of the estate in the first place.[135] While both opinions have language that seems to endorse a general "no harm, no foul" rule,[136] the interest in property at stake in

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[128] *In re* Panepinto, 487 B.R. 370, 371 n.2 (Bankr. W.D.N.Y. 2013).

[129] Begier v. I.R.S., 496 U.S. 53,58 & n.1 (1990); Bear, Stearns Sec. Corp. v. Gredd, 275 B.R. 190, 194-96 (S.D.N.Y. 2002).

[130] *See Begier*, 496 U.S. at 58; *see also Bear, Stearns*, 275 B.R. at 196.

[131] 11 U.S.C. § 544(b)(1).

[132] *Bear, Stearns*, 275 B.R. at 194 (quoting Sullivan v. Stroop, 496 U.S. 478, 484 (1990)).

[133] *Panepinto*, 487 B.R. at 371 n.2.

[134] *Id.*

[135] *Begier*, 496 U.S. at 59 ("Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not 'property of the estate.'"); *Bear Stearns*, 275 B.R. at 198 ("[W]e conclude that the transfers sought to be avoided were not transfers of 'an interest of [the Fund] in property' because the federal securities laws do not permit non-brokerage house creditors to recover the transferred assets.") (second alteration in original).

[136] *Begier*, 496 U.S. at 58 ("Of course, if the debtor transfers property that would not have been available for distribution to his creditors in a bankruptcy proceeding, the policy behind the avoidance power is not implicated."); *Bear Stearns*, 275 B.R. at 195 ("A transfer of property, even if made with fraudulent intent, that does not leave any creditor in a worse position than he would have been had the transfer never occurred, obviously does not offend the policy behind § 548(a)(1)(A).").

Panepinto is fundamentally different than the interest in property at stake in either *Begier* or *Bear Stearns*.

Consequently, these cases do not provide a firm ground for holding that a transfer of exempt property cannot be fraudulent as to the debtor's creditors. The court would also have to address both the fact that a majority of courts reject the "no harm, no foul" rule when it comes to exempt property, and that the clear language of the Code indicates a congressional intent to capture such transfers.[137] Further, there are also policy reasons for not extending the "no harm, no foul" rule to bankruptcy.

2. Problems With the "No Harm, No Foul Rule" in the Bankruptcy Context

Excluding transfers of exempt property from the Code's fraudulent transfer provisions would likely create more problems than it would solve. In *Lasich v. Wickstrom*, the Bankruptcy Court for the Western District of Michigan addressed some of the policy reasons for not adopting the "no harm, no foul" rule.[138] It presented several hypothetical situations concerning application of the "no harm, no foul" rule, one of which does an excellent job highlighting a potentially serious problem and is worth exploring.

In the hypothetical, the court imagined a couple who decide to transfer their home to a third party on the eve of bankruptcy and then elect to take the federal exemptions under 11 U.S.C. § 522(d)(1) and (5).[139] The court then asked whether preventing the trustee from avoiding this transfer under the "no harm, no foul" rule really would result in no harm to the debtors' creditors.[140] The answer, of course, is no. Preventing fraudulent transfer law from reaching this transfer could result in serious harm to creditors. Before seeing exactly why this is the case, it is important to briefly discuss the difference between state and federal bankruptcy exemptions.

Many states, including New York, allow debtors filing for bankruptcy to elect either the federal exemptions or the exemptions available under state law.[141] This option matters for

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[137] Yankowitz, *supra* note 108, at 229-33.

[138] *See generally* Lasich v. Wickstrom (*In re* Wickstrom), 113 B.R. 339 (Bankr. W.D. Mich. 1990).

[139] *Id.* at 348.

[140] *Id.*

[141] *See* N.Y. DEBT. & CRED. LAW §§ 284-285 (McKinney 2012). New York used to limit debtors to only the exemptions available under state law. DEBT. & CRED § 284. When this was changed with the passage of § 285, the legislature left § 284 as it was. A

New York residents because the New York homestead exemption is much more generous than the federal homestead exemption.[142] A person who has any significant amount of equity in her home will typically elect the state exemptions in order to protect what is usually her largest asset.[143]

However, when it comes to personal property, the federal exemptions can be much more generous than New York's. Many exemption schemes (including both federal and New York) exempt property based on category and dollar limit.[144] For example, under New York law, a debtor is allowed to exempt a car worth up to $4,000, professional tools up to $3,000, jewelry up to $1,000, etc.[145] Federal law is similar.[146] However, federal law has a provision found in 11 U.S.C. § 522(d)(5) that is often referred to as the "wild card" exemption.[147] This provision allows a debtor to exempt *any* type of personal property up to a limit of $1,225.[148] This subsection also allows the debtor up to an additional $11,500 from any unused portion of the federal homestead exemption.[149] Therefore, a debtor who is not claiming a homestead exemption can exempt a total of $12,725 worth of *any* property the debtor chooses under the federal exemptions. The wild card exemption is in addition to the other categorical exemptions allowed under § 522(d). If a debtor is eligible for all the personal property exemptions under federal law, the total value of exempt property can reach above $30,000.[150] New York state law has no wild card exemption and also caps personal property exemptions at $10,000.[151] Thus, if a debtor has both a home and

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person only reading § 284 might conclude that New York law only allows state exemptions, but § 285 states that an individual debtor may choose the federal exemptions instead "[n]otwithstanding any inconsistent provision of law." DEBT. & CRED. § 285.

142 *Compare* N.Y. C.P.L.R. § 5206 (McKinney 2012) (allowing $150,000, $125,000, or $75,000, depending on county of residence), *with* 11 U.S.C. § 522(d)(1) (2013) (allowing $22,975).

143 *See* Brian Powers, Note, *Can You Trust Your Trustee? Expanding Homestead Exemptions to Include Rent-Controlled Leasehold Interests*, 20 AM. BANKR. INST. L. REV. 741, 748 (2012).

144 *See, e.g.*, 11 U.S.C. § 522(d); N.Y. C.P.L.R. § 5205; MASS. GEN. LAWS 235 § 34 (2014).

145 N.Y. C.P.L.R. § 5205.

146 11 U.S.C. § 522(d) (allowing up to $12,250 worth of household goods, $1,550 worth of jewelry, etc.).

147 *See, e.g.*, Martin v. Cox (*In re* Martin), 140 F.3d 806, 807 (8th Cir. 1998) (discussing the wild card exemption).

148 11 U.S.C. § 522(d)(5).

149 *Id.* This is approximately half of the total $22,975 allowed under § 522(d)(1).

150 *See* 11 U.S.C. § 522(d).

151 N.Y. DEBT. & CRED. LAW § 283 (McKinney 2012).

a significant amount of personal property, the question of which exemption scheme to choose poses a serious dilemma.

Let us return to the hypothetical raised by the *Wickstrom* court and add some more facts. Assume the husband and wife own the home jointly and the husband also owns an expensive automobile currently worth around $10,000. The home is located in Manhattan, and their equity in the property is under the $150,000 cap for New York's homestead exemption.[152] If the husband were to file for bankruptcy and elect state exemptions, they could keep the house but would lose the car.[153] However, if the husband transfers the house solely to his wife before he files, he would not have to worry about taking an exemption for the house and could choose the federal exemption scheme. Under the federal exemptions, and without having to worry about a homestead exemption, he could use the wild card provision to fully exempt the car.[154]

Such a transfer on the eve of bankruptcy is a classic fraudulent transfer, but if the "no harm, no foul" rule were in play, the trustee would be unable to do anything about it. The debtor has now benefitted from both the federal and state exemptions at the expense of his creditors. This is a clear case of a transfer designed to hinder, delay, or defraud creditors and fraudulent transfer law should be able to reach it. Extending the "no harm, no foul" rule to this case allows the debtor to protect assets (in this case, an expensive car) that should otherwise be available to his creditors.

Thus, extending the "no harm, no foul" rule to generally cover all transfers of exempt property in bankruptcy is not a viable solution. Not only could it result in serious harm to creditors, such as in the hypothetical above, but a majority of bankruptcy courts have already rejected it.[155] However, the law being used to avoid the transfer in *Panepinto* is based on state

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[152] One hundred fifty thousand dollars is the current maximum exemption for real property used as a primary residence in the county of New York. N.Y. C.P.L.R. § 5206 (McKinney 2012).

[153] New York law caps the exemption value of automobiles at $4,000. N.Y. C.P.L.R. § 5205(8) (McKinney 2012). The husband would still be able to take advantage of this exemption, but since the car is worth more than the exemption, the trustee would be able to sell the car as part of the estate. *See, e.g.*, In re Mannone, 512 B.R. 148, 153-54 (Bankr. E.D.N.Y. 2014) (noting that the trustee may only sell exempt property when the sale will realize value above the exemption limit and that any such value in exempt property sold by the trustee inures to the benefit of the estate). After the sale, the husband would receive $4,000 (the exemption amount) from the sale proceeds with the remainder going to the estate.

[154] Federal law caps the exemption value of automobiles at $3,675, but the wild card exemption (assuming no homestead) could easily cover the remaining value. 11 U.S.C. § 522.

[155] *See* Yankowitz, *supra* note 108, at 219.

law, not federal law. Thus, state law precedent could provide grounds for overturning the *Panepinto* decision.

3. State Law Precedents

The transfers in *Begier*, *Bear Stearns*, and the *Wickstrom* hypothetical are both subject to either §§ 547 or 548 of the Bankruptcy Code. However, the transfer in *Panepinto* concerned application of § 544 and New York's UFCA. Under § 544, the trustee can avoid any transfer that a valid creditor of the debtor could otherwise avoid under applicable law.[156] In this case, the applicable law is New York's version of the UFCA.

The court in *Panepinto* concluded that New York's version of the UFCA allowed the avoidance of fraudulent conveyances of exempt property. However, there are no New York cases directly on point, and there are some New York cases that even seem to support the "no harm, no foul" rule. There is also a long history of similar holdings from other states. The "no harm, no foul" rule was originally applied in the context of state-level fraudulent transfer law and numerous state courts have held that a transfer of property that is not reachable by creditors due to statutory exemption cannot be fraudulent.[157] While this impressive list of decisions is not

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[156] 11. U.S.C. § 544(b)(1) (2013).

[157] *See, e.g.*, Flirt v. Kirkpatrick, 175 So. 2d 755, 758 (Ala. 1965) ("A sale or other disposition of property which is by law exempt from payment of debts cannot be impeached by creditors as fraudulent, since creditors cannot be deemed concerned with property not subject to their demands."); Montgomery v. Bullock, 77 P.2d 846, 849 (Cal. 1938) ("[A] creditor is not entitled to complain of the transfer by the debtor of an asset which he could not have reached, had the debtor retained it."); Sneed v. Davis, 184 So. 865, 870 (Fla. 1938) ("[T]he corporate stock at the time of the alleged fraudulent conveyance was exempt from sale under execution and, therefore, was property which could not be subjected to the claim of the creditor against the consent of the owner and as to which there could be no conveyance in legal fraud of creditors."); St. Marie v. Chester B. Brown Co., 370 P.2d 195, 197 (Idaho 1962) ("If the property, before transfer, was exempt from execution then a creditor could not reach it and a subsequent transfer would deprive the creditor of no rights."); Rossow v. Peters, 115 N.E. 524, 525 (Ill. 1917) ("[A] conveyance of property exempt from the payment of debts is not fraudulent as to creditors."); Isgrigg v. Pauley, 47 N.E. 821, 821 (Ind. 1897) ("The whole doctrine of annulling fraudulent conveyances rests upon the ground that the creditor has the right to resort to the property, and where he has no such right it is impossible that a conveyance can be deemed fraudulent."); Hall Roberts' Son, Inc. v. Plaht, 114 N.W.2d 548, 549 (Iowa 1962) ("As sometimes said, so far as exempt property is concerned, there are no creditors."); Saunders v. Graff, 173 P. 413, 413 (Kan. 1918) ("[T]here is no fraud in withholding exempt property from satisfaction of a debtor's obligations. Creditors are not concerned with any disposition which the owner may make of it."); Tewmey v. Tewmey's Assignee, 65 S.W.2d 479, 482 (Ky. 1933) ("[C]reditors cannot be defrauded, hindered, or delayed by the transfer of property which neither at law nor in equity can be made to contribute to the satisfaction of their debts, and hence it is almost universally conceded that property which is by statute exempt from execution cannot be reached by creditors on the ground that it has been fraudulently transferred.");

binding on New York, there is also no precedent to the contrary. Further, at least two older New York cases and one modern case suggest that New York law also excludes exempt property from fraudulent transfer law.

The first of the two older cases is *Zoeller v. Riley*, decided by the New York Court of Appeals in 1885.[158] In a note following the opinion that appears unrelated to the case at hand, the court stated that "the conveyance of property exempt from execution cannot, under any circumstances, be made out to be a fraudulent conveyance."[159] However, as this is not part of the official opinion and does not relate to the facts of the case, it is dicta at best. Further, this case and the one that follows were decided prior to New York's adoption of the UFCA and its definition of "conveyance."

The second older case is *McDonald v. McDonald*,[160] where a defendant against whom a judgment had been obtained transferred all of her property away before the judgment could be satisfied.[161] The plaintiff brought an action to avoid the transfers.[162] The New York Supreme Court held the transfers fraudulent and affirmed judgment for the plaintiff.[163] However, at the end of the opinion, the court

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Legro v. Lord, 10 Me. 161, 165 (1833) ("No creditor *can be*, in legal contemplation, defrauded by a mere conveyance made by his debtor of any of his property, which such creditor has no right by law to appropriate or even to touch by any civil process."); Mannan v. Merritt, 93 Mass. 582, 583 (1866) ("A creditor cannot by an attachment impeach the validity of the sale by his debtor of articles which are exempt by law from attachment, upon the ground that such sale was fraudulent as to creditors."); Bresnahan v. Nugent, 52 N.W. 735, 736 (Mich. 1892) ("It has been frequently held that a creditor cannot complain of any disposition which a debtor sees fit to make of exempt property."); Sisco v. Paulson, 45 N.W.2d 385, 387 (Minn. 1950) ("Exempt property is not susceptible of fraudulent alienation, and creditors ordinarily have no right to complain of the disposition made of it, since they cannot be prejudiced thereby or claim that it is a fraud upon them."); Chandler v. Welborn, 294 S.W.2d 801, 805 (Tex. 1956) ("It is well settled that a conveyance of exempt property may not be attacked on the ground that it was made in fraud of creditors."); Payson Exch. Sav. Bank v. Tietjen, 225 P. 598, 600 (Utah 1924) ("A homestead cannot be made the subject of attack by a creditor upon the ground that it was sold or conveyed in fraud of such creditor."); Darling v. Ricker, 35 A. 376, 377 (Vt. 1896) ("There can be no fraud as against creditors in the conveyance of property exempt from attachment."); Boynton v. McNeal, 72 Va. 456, 460 (1879) ("[A] creditor cannot be said to be hindered, or delayed, or prejudiced by a fraudulent conveyance embracing property subject to the homestead, because the debtor is entitled to hold it exempt from the payment of his debts."); First Wis. Nat. Bank of Milwaukee v. Roehling, 272 N.W. 664, 664 (Wis. 1937) ("It has always been the rule in this state that a conveyance of property which is exempt cannot be deemed fraudulent as against creditors."); *see also* 37 AM. JUR. 2D *Fraudulent Conveyances & Transfers* § 74 ("A debtor's transfer of an interest in property that is exempt cannot be fraudulent as to creditors.").

158 Zoller v. Riley, 2 N.E. 388 (N.Y. 1885).

159 *Id.* at 399.

160 McDonald v. McDonald, 11 N.Y.S. 248 (Gen. Term 1890).

161 *Id.* at 248.

162 *Id.*

163 *Id.* at 249.

discussed a point "suggested by the appellant which should have some further consideration."[164] The court noted that these transfers included some furniture and other household goods that were exempt property beyond the reach of creditors.[165] The court flatly stated that the creditors of the defendant were not defrauded by the transfer of the exempt property.[166] While the court affirmed the judgment, it modified it to exclude any property subject to exemption from execution.[167]

The more recent case is *Prestige Caterers, Inc. v. Siegel*.[168] In this Appellate Division case from 2011, the defendants hired a catering company but never paid the bill.[169] The catering company sued and obtained a judgment.[170] In the course of enforcing the judgment, the catering company sought to set aside several transfers as fraudulent.[171] The defendants sought to dismiss the complaint arguing that the transfers in question could not be fraudulent because they consisted of social security benefits that were exempt from execution by creditors.[172] The court ultimately denied the motion because the complaint also alleged transfers of funds that were not social security benefits.[173] While the court did not directly address the issue, the implication from the court's language was that it would have dismissed the complaint had it only alleged transfer of exempt funds.[174]

Looking at these three New York cases, the lack of any New York precedent going the other direction, and the numerous decisions from other jurisdictions, the Bankruptcy Court could potentially rule that, as a matter of state law, a

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164 *Id.*
165 *Id.*
166 *Id.*
167 *Id.*
168 Prestige Caterers, Inc. v. Siegel, 930 N.Y.S.2d 272 (N.Y. App. Div. 2011).
169 *Id.* at 273.
170 *Id.*
171 *Id.*
172 *Id.*
173 *Id.*
174 *Id.* ("Although social security benefits are protected from execution, levy, attachment, garnishment, or other legal process, and, therefore, do not constitute assets as defined in Debtor and Creditor Law § 270, the complaint adequately alleges the fraudulent conveyance of other assets and funds which are not exempt from liability for [the alleged] debts." (alteration in original) (internal quotation marks omitted) (citations omitted)). Note that when discussing the social security benefits, the court states they "do not constitute 'assets' as defined in Debtor and Creditor Law § 270." *Id.* The defendants moved to dismiss the complaint on the grounds that the property transferred was exempt and therefore could not be fraudulent. *Id.* However, as discussed above, a fraudulent conveyance under New York law is not concerned with the transfer of 'assets' as defined by § 270; it is concerned with property. *See supra* note 65 and accompanying text. One wonders whether any of the lawyers involved in this case brought this distinction to the attention of the court.

transfer of exempt property cannot be fraudulent. As the *Panepinto* court pointed out, "11 U.S.C. § 544 is different."[175] It would not be inconsistent with federal court precedent to hold that §§ 547 and 548 can reach a transfer of exempt property and that § 544(b) cannot. Section 544(b) turns on state law and not federal law, so a court would be justified in holding that a transfer of exempt property, while subject to fraudulent transfer law under the provision found in the Code itself, was not subject to state fraudulent transfer law.

The court in *Blanch* endorsed a very similar conclusion.[176] In that case, the court compared §§ 544 and 548, stating that "[t]he trustee's powers to avoid transfers under each provision are wholly separate and independent of one another."[177] Specifically, the court noted that "cases decided under the Bankruptcy Code . . . rejected the 'no harm, no foul'" rule, but that this did not affect the analysis under state law.[178] Because avoidance under § 548 is based on the Bankruptcy Code and avoidance under § 544(b) is based on state law, there is no inconsistency in holding that they operate differently. What mattered in this case was how Illinois state law would treat the transfers in question.

There are also policy reasons to treat avoidance under § 548 differently from avoidance under § 544(b). Section 548, as the court in *Panepinto* noted, is concerned with the "slide into bankruptcy."[179] It can only reach transfers that were made within two years of the bankruptcy filing.[180] Most state fraudulent transfer laws reach back further than two years. New York provides for a six-year statute of limitations on fraudulent conveyance actions[181] and most UFTA jurisdictions apply a four-year statute of limitations.[182] A transfer, regardless of actual intent, made immediately before filing for bankruptcy is inherently more suspicious than one made several years before filing. Presumably, a debtor is much more aware of financial distress closer to filing and should be more careful in the disposition of his assets.

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175 *In re* Panepinto, 487 B.R. 370, 371 n.2 (Bankr. W.D.N.Y. 2013).

176 *In re* Blanch, Nos. 97-82652, 98-8011, 1998 WL 34065289 at *2 (Bankr. C.D. Ill. Sept. 11, 1998).

177 *Id.*

178 *Id.*

179 *Panepinto*, 487 B.R. at 371 n.2.

180 11 U.S.C. § 548(a)(1) (2013).

181 Orr v. Kinderhill Corp., 991 F.2d 31, 35 (2d Cir. 1993) (holding that constructive fraud actions under New York law are subject to six-year statute of limitations).

182 *See, e.g.*, 740 ILL. COMP. STAT. 160/10 (2014); MASS. GEN. LAWS ch. 109A § 10 (2014); UNIF. FRAUDULENT TRANSFER ACT § 9 (1984).

One justification for constructive fraud provisions is to do away with ambiguous questions of intent. As previously noted, actual intent to hinder, delay, or defraud creditors is rarely susceptible to direct proof. In devising the objective markers that make a transfer fraudulent without regard to the intent of the transferor, the drafters of the UFCA knew that they would likely sweep up some transfers that were made without any intent to defraud creditors.[183] This was considered acceptable when balancing out the policy goals of the statute.[184]

In the same spirit, applying such provisions with more force immediately before the bankruptcy makes sense. It is much more likely that a transfer right before filing for bankruptcy will harm creditors. Zealously going after potentially fraudulent transfers made in a short time period before bankruptcy fits with the goals of the system. However, it also makes sense to be a bit more forgiving when it comes to transfers made as long ago as six years prior to a bankruptcy filing, particularly when the result could be the debtor losing a home that her creditors never had any legal right to in the first place. If a debtor tries to engage in the sort of subterfuge that hinders, delays, or defrauds creditors she should not be rewarded. But that does not mean that a creditor should enjoy advantages it was never entitled to. The result would be to force a family out of their home because a completely innocent transfer ran afoul of an archaic law.

Despite both the case history and the sound policy reasons for holding that a transfer of exempt assets is not subject to state fraudulent transfer law, the fact remains that the plain language of the UFCA in New York, combined with the Bankruptcy Code, seem to compel this result. New York law defines "conveyance" as any transfer of property without respect to exemption.[185] It is unclear whether a New York court would rule that the transfer in *Panepinto* was fraudulent. The best solution is for New York to join the rest of the country and adopt the UFTA.

B. Solving the Exemption Problem with the UFTA

The Conference is currently considering amendments to the UFTA (now known as the Uniform Voidable Transactions

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183 Baird & Jackson, *supra* note 15, at 831-32.

184 *See* Kennedy, *Involuntary*, *supra* note 42, at 534-35 (discussing how the drafters of the UFCA wanted to eliminate questions of intent in order to improve creditors' remedies).

185 N.Y. DEBT. & CRED LAW § 270 (McKinney 2012).

Act (UVTA)).[186] The release of the UVTA is an excellent opportunity for New York to join the other 43 states that have already adopted some version of the UFTA.[187]

The failure of New York to adopt a version of the UFTA to date threatens the state exemption system. The exemptions are there for a reason. The property set aside as exempt from creditors is the property the state has decided is essential to everyday life. Stripping debtors of this property creates social costs that far outweigh the costs of leaving some debt uncollected. The goal should be to strike a balance between ensuring creditors are paid, which is essential to a healthy credit system, and preventing debtors from becoming wards of the state. Bankruptcy goes hand-in-hand with this system to prevent debtors from falling into a cycle of debt they can never escape.

Society and the economy as a whole are better off when people can live normal lives and make positive contributions to the economy. It is also important for the economy to maintain a healthy credit system, and, to do that, we must have procedures in place to ensure creditors are paid.[188] But this can also go too far. Allowing creditors to take everything debtors own risks putting debtors in a position where they have no alternative but to live on public assistance.[189] This in turn raises costs for the rest of society.

Both goals are important. Proper recovery mechanisms for creditors in the case of default encourage lenders to make more loans.[190] Access to credit is not only essential to the modern economy,[191] it can also be a key factor in reducing poverty and promoting economic development.[192] However, it is well-settled "that exemptions in bankruptcy are to be liberally construed in order to afford the honest debtor a fresh start."[193] The debtor's fresh start is important because not only does it help the debtor and her family, it also provides "benefits [to]

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[186] NAT'L CONF. OF COMMR'S ON UNIF. STATE LAWS, UNIF. VOIDABLE TRANSACTIONS ACT (FORMERLY UNIF. FRAUDULENT TRANSFER ACT) (formerly THE UNIF. FRAUDULENT TRANSFER ACT) (as amended in 2014), *available at* http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2014AM_AUVTA_Draft_As%20approved.pdf.

[187] *See* UNIF. FRAUDULENT TRANSFER ACT, references & annots (2006) (outlining the UNIF. FRAUDULENT TRANSFER ACT, adopted in 43 jurisdictions.).

[188] *See* Kennedy, *Involuntary*, *supra* note 42, at 534.

[189] *Bankruptcy Exemptions*, *supra* note 22, at 1459.

[190] Luke Shimek & Rajdeep Sengupta, *Access to Credit*, ECONOMIC SYNOPSES no. 4, 2007, *available at* https://research.stlouisfed.org/publications/es/07/ES0704.pdf.

[191] Jacques Sapir, *Credit, Indebtedness and Economic Growth*, RUSSEUROPE, (Sept. 1, 2013, 10:29 PM), http://russeurope.hypotheses.org/1500.

[192] Shimek & Sengupta, *supra* note 190.

[193] *In re* Abbott, 408 B.R. 903, 911 (Bankr. S.D. Fla. 2009).

the rest of society by reviving the debtor's incentive to work and participate productively in the economy."[194]

Thus, it is important to strike a balance between ensuring creditors are paid and preventing debtors from becoming wards of the state. We need a system that allows creditors a sufficient recovery to keep credit flowing at reasonable rates while at the same time ensuring that debtors have enough protections to recover if they find themselves unable to pay their debts. The system of exemptions is a key part of that balance. If we then allow the law to undermine and frustrate those exemptions unnecessarily, we risk upsetting the balance and causing harm to the economy.

There is also a moral dimension to limiting how much creditors should be allowed to take. As a society, we do not want to see debtors stripped of everything they own and forced onto the street. Creditors should not be allowed to literally strip a debtor naked and take everything, from the family house to the debtor's books and even pets. The exemption laws in this country protect the things that are essential for a person to live with dignity in modern society. We should not allow this system to be undermined by a technical definition of the word "conveyance."

There is also no policy reason to hold exempt property subject to state fraudulent transfer law. The purpose of the law is to recover property that can be used to pay creditors. The exemption scheme is specifically designed to put certain property beyond the reach of creditors. Allowing fraudulent transfer law to alter the balance clearly intended by the legislature undermines the policy goals of the exemption statutes. Simply put, *not* updating the law is against the policy of the state.

That is not to say no potential issues exist if New York were to adopt the UFTA or otherwise protect transfers of exempt property from fraudulent transfer law. If fraudulent transfer law could never reach exempt assets, it would be possible for someone who owns a house to transfer that house to a third party for no consideration, then use all his remaining assets to purchase a new, exempt house. When he files for bankruptcy, he will have no non-exempt assets, and the trustee will be unable to avoid the transfers. Here, we see a debtor exploiting the rules to hinder, delay, or defraud creditors. However, there are several solutions to this problem. First, in order to take

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[194] Marianne B. Culhane & Michaela M. White, *But Can She Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases*, 7 FORDHAM J. CORP. & FIN. L. 471, 473 (2002).

advantage of the UFTA, he would have to have transferred the house more than two years before filing for bankruptcy. Otherwise, the transfer could simply be avoided under 11 U.S.C. § 548 which reaches transfers of exempt property.[195]

Second, the bankruptcy courts have always retained the ability to dismiss cases when they find the debtor has abused the Bankruptcy Code. Under 11 U.S.C. § 707(b)(3)(A), the bankruptcy court can dismiss the case if it finds the petition was not filed in good faith.[196] It is not hard to imagine a bankruptcy court finding that the actions of our hypothetical debtor in exploiting the exemption system to prevent substantial assets from becoming available to his creditors constitutes bad faith and abuse of the system.

Third, if these protections are not enough for the legislature, it can always add additional protections as part of the adoption of the UVTA. An easy example would be to generally exclude transfers of exempt property from the constructive fraud provisions while specifically *including* exempt property in cases where there is evidence of actual fraud. All the legislature would need to do is set out a separate section making it clear that transfers made with actual intent to hinder, delay, or defraud creditors are voidable regardless of any exemptions that may apply to the property transferred.

Even if the New York legislature chooses not to adopt the UVTA, there is still a simple fix available: they can redefine "conveyance" to exclude exempt property. This would require simply changing the word "property" to "asset" in the definition of "conveyance" found in NYDCL section 270. The current law already defines "asset" to exclude exempt property.[197] This change will promote the policy objectives of the exemption statutes, but will not undermine any current policy objectives of fraudulent transfer law.

CONCLUSION

For the debtor in *Panepinto*, this particular saga is over as the court confirmed the debtor's plan.[198] But the underlying issue—whether transfers of exempt assets are subject to

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[195] *See supra* note 136 and accompanying text.

[196] 11 U.S.C. § 707(b)(3)(A) (2013).

[197] N.Y. DEBT. & CRED. LAW § 270 (McKinney 2012).

[198] The court in *Panepinto* confirmed the Debtor's plan on Dec. 30, 2013. *Panepinto* Docket, *supra* note 74. A further review of the docket indicates that the specific controversy with the main creditor has been settled. *Id.* The specific details are not currently available, but no fraudulent transfer adversary proceeding was filed. *Id.*

fraudulent transfer law in New York—remains unresolved. Now that a bankruptcy court has opened the door to challenging this type of transfer, trustees in future cases could potentially sell an entirely exempt homestead out from under an innocent debtor. Trustees are not in the business of kicking debtors out of their homes, but they have a fiduciary duty, imposed by law, to get the best return on a debtor's assets for the benefit of the estate. The only way to ensure that this tragic scenario does not occur at some point in the future is to change the law.

Adopting the UVTA would not be inconsistent with the current fraudulent conveyance law in New York. There is no indication the legislature intended to expose exempt property to fraudulent transfer law. If the dispute in *Panepinto* were outside bankruptcy, then, even if the transfer was avoided, the house would still be exempt because it would return to the debtor under the homestead exemption. If New York had intended for exempt property that was fraudulently transferred to be available to creditors, there would be some mechanism in state law to strip the exemption after avoidance. The lack of such a provision creates the inference that the legislature did not intend for exempt property to lose its exempt status because it was part of a constructively fraudulent transfer.

To remedy this situation and ensure that the exemption system functions as it is supposed to, New York should take the upcoming amendments to the UFTA as an opportunity to update its fraudulent transfer law and join almost every other state in upholding the integrity of exempt property. If the state declines to do this, it should, at a minimum, change the definition of "conveyance" in the fraudulent transfer statutes to ensure that the exemption laws work as they should: to protect property essential to everyday life.

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