

Brooklyn Law Review

Volume 72

Issue 1

SYMPOSIUM:

Justice Blackmun and Judicial Biography: A
Conversation With Linda Greenhouse

Article 11

2006

Enhancing Creditor Recovery: Should Services be Deemed "Property" for the Purpose of Fraudulent Transfer Law?

Oksana Lashko

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/blr>

Recommended Citation

Oksana Lashko, *Enhancing Creditor Recovery: Should Services be Deemed "Property" for the Purpose of Fraudulent Transfer Law?*, 72 Brook. L. Rev. (2006).

Available at: <https://brooklynworks.brooklaw.edu/blr/vol72/iss1/11>

This Note is brought to you for free and open access by the Law Journals at BrooklynWorks. It has been accepted for inclusion in Brooklyn Law Review by an authorized editor of BrooklynWorks.

Enhancing Creditor Recovery

SHOULD SERVICES BE DEEMED “PROPERTY” FOR THE PURPOSE OF FRAUDULENT TRANSFER LAW?

INTRODUCTION

On the eve of his bankruptcy filing, Warren Ruffet, who has recently found himself in financial turmoil, gives his neighbor some valuable investment advice. Several months later, the lucky neighbor quadruples her wealth, cashing in five million dollars from the sale of Warren’s stock pick. Meanwhile, on the other side of town, Tom Jones, an established plastic surgeon operates on a patient, who has been badly scarred in a car accident. For personal reasons, Jones charges the patient only ten percent of what would have been a very expensive procedure. The operation turns out to be a success. Some months later, Jones, burdened by several ongoing malpractice lawsuits and rising insurance costs, files for bankruptcy.

While factually different, the above scenarios have one thing in common: both debtors provided services just before their bankruptcy filings. Considering that Ruffet and Jones are now in bankruptcy, their creditors can no longer engage in individual collection efforts. The filing of a bankruptcy petition operates as a temporary injunction against all collection activities.¹ Because the bankruptcy laws prevent creditors from pursuing individual collection efforts, as a quid pro quo, a debtor cannot engage in creditor-harmful behavior by hiding his assets.² Fraudulent transfer laws protect creditors from

¹ In bankruptcy, this temporary injunction is called an automatic stay, because it stops all creditors from collection and enforcement activities against the debtor or his property. The automatic stay, among other things, prevents creditors from attempting to collect any pre-bankruptcy claims or from enforcing any pre-bankruptcy judgments. 11 U.S.C.S. § 362 (LexisNexis 1995, Cumulative Supp. Apr. 2005 [hereinafter Supp. 2005] & Cumulative Later Case & Statutory Service Supp. Jan. 2006 [hereinafter Supp. 2006]). Title 11 of the United States Code is commonly referred to as the Bankruptcy Code [hereinafter, the “Code” or the “Bankruptcy Code”].

² For example, without fraudulent transfer laws, a debtor could simply have a friend hold on to the debtor’s valuable personal property on the eve of bankruptcy so that the creditors do not get it. Likewise, the debtor could transfer the title to his

such a manipulation of assets by reversing any property transfer made by a debtor on the eve of bankruptcy that diminishes or depletes the debtor's estate.³

In our hypotheticals, although Ruffet and Jones have made their creditors worse off by providing uncompensated services, their actions appear to be legitimate from a fraudulent transfer law perspective.⁴ This is so because generally, the prototypical debtor defrauds his creditors by transferring *property*, and not services, on the eve of bankruptcy.⁵ Section 548 of the Bankruptcy Code explicitly prohibits such kind of transfers.⁶ The boundaries of fraudulent transfer law, however, become less clear when an insolvent debtor does not transfer any property but simply performs uncompensated services, as Ruffet and Jones did in the above examples.⁷

Currently, under the Bankruptcy Code and existing case law, it is unclear whether Ruffet's or Jones' creditors can recover the fair market value of their services from their third party recipients.⁸ This lack of clarity stems from the fact that fraudulent transfer law deals only with transfers of *property* and not transfers of services.⁹ Indeed, section 548 of the Bankruptcy Code speaks of liability in the context of transfers

house to his girlfriend with the understanding that she would transfer the title back once the bankruptcy case was over. Both of these fraudulent transfers would deprive the debtor's creditors of valuable assets that they could have collected but for the debtor's bankruptcy filing. Thus, in order to avoid such asset manipulation by the debtor at the expense of his creditors, the Bankruptcy Code provides for various mechanisms, including preference, *id.* § 547 (LexisNexis 1997, Supp. 2005 & Supp. 2006), and fraudulent transfer provisions, *id.* § 548 (LexisNexis 1997, Supp. 2005 & Supp. 2006), which serve as a check on the debtor's pre-bankruptcy behavior.

³ The fundamental remedy for a fraudulent transfer is to avoid, or set aside, that transfer. *Id.* § 548(a). In other words, the transfer is disregarded and creditors can recover the property itself or the value of the property from the third party. *Id.* § 550(a) (LexisNexis 1997).

⁴ If both of them had been paid for these services, their creditors would have been entitled to that money upon the debtors' bankruptcy filings. Eventually, the money would have been distributed equally on a pro rata basis to same-situated creditors. *Id.* § 550. Moreover, fraudulent transfer laws seek to prevent a debtor's transfer of property to a third party that unfairly hampers the creditor's ability to collect from the debtor. *Id.* § 548. In our two hypotheticals, neither Ruffet nor Jones transferred any property on the eve of bankruptcy. Instead, they simply provided services.

⁵ *Id.* § 548(a)(1)(B)(ii)(I)-(IV).

⁶ *Id.* § 541(a) (LexisNexis 1997).

⁷ Typically, services are defined as "[a]n intangible commodity in the form of human effort, such as labor, skill, or advice." BLACK'S LAW DICTIONARY 1372 (7th ed. 1999).

⁸ 11 U.S.C.S. § 541(a).

⁹ See *infra* discussion and accompanying notes in Part I.C.

of property, not services.¹⁰ However, if bankruptcy courts were to classify services as property for the purposes of fraudulent transfer law, then creditors would have the power to collect the value of such services from third party recipients. Thus, the determination of whether services should be deemed property tests the limits of fraudulent transfer law and weighs directly on one of the major bankruptcy policies—the maximization of debtors’ assets for the benefit of creditors.¹¹

This Note addresses the question of whether services provided by a debtor to a third party should be deemed a transfer of property for the purpose of valuing the debtor’s estate.¹² As it now stands, services are not property under the traditional definition of the term.¹³ Nonetheless, ending the inquiry here seems premature. In a bankruptcy context, courts can expand the concept of property to include services. Yet, endorsing the blanket statement that services are always property seems equally unsound. Considering the already-prevalent pro-creditor sentiment of the Bankruptcy Code, such an approach would not only forestall the debtor’s recuperation efforts in bankruptcy, but also would interfere with the rights of third parties and cause them undue hardship despite their lack of privity with creditors.

Part I of this Note provides an overview of fraudulent transfer theory under federal and state law. Part II examines the question of whether services should be deemed “property” for the purposes of fraudulent transfer law. It provides an overview of section 548 of the Bankruptcy Code, which specifically authorizes the trustee to challenge certain transfers deemed fraudulent.¹⁴ Also, it explains the concept of property as it is currently viewed under the fraudulent transfer scheme and draws parallels to cases dealing with marital division of assets on divorce. The marital cases provide a good reference in this context because divorce proceedings usually require courts to determine the value of a spouse’s services for the purpose of dividing marital assets. Part III describes the equitable approach used by marital courts and its application

¹⁰ See 1 GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCE § 212 (1940) [hereinafter GLENN, FRAUDULENT CONVEYANCES].

¹¹ See *infra* discussion and accompanying notes in Part I.A.

¹² The commencement of a bankruptcy case creates an “estate.” The bankruptcy estate is comprised initially of all of the debtor’s interests in property at the time the case begins. 11 U.S.C.S. § 541.

¹³ See *supra* notes 9-10 and accompanying text.

¹⁴ 11 U.S.C.S. § 548.

in the fraudulent transfer context. As an alternative, it then introduces the selective approach to services under the “underlying chattel” theory.¹⁵ The “underlying chattel” theory argues that services should not be deemed property unless they “culminate in transferable property.”¹⁶ In other words, if the performance of an uncompensated service confers a transferable asset on its recipient, then the bankruptcy courts should construe it as a transfer of property.¹⁷ In contrast, if an uncompensated service confers an intangible inalienable benefit, then the courts should not classify such services as a transfer of property. Part III also advances arguments for and against considering services “property” in the fraudulent transfer context from the debtor, creditor and third party perspectives.

I. OVERVIEW OF FRAUDULENT TRANSFER LAW

The modern fraudulent transfer law originated from England’s Statute of 13 Elizabeth, passed in 1571.¹⁸ Later, the law continued to evolve in the Uniform Fraudulent Conveyance Act (“UFCA”), the Bankruptcy Act of 1978, and most recently, the Uniform Fraudulent Transfer Act (“UFTA”).¹⁹ Although fraudulent transfer law has evolved, its application to modern transactions has remained difficult due to various evidentiary challenges.²⁰ The law’s response to these challenges has

¹⁵ This approach comes from the Alabama Supreme Court’s opinion in *American National Red Cross v. ASD Specialty Healthcare*, 888 So. 2d 464, 466 (Ala. 2003). In addition, the notion of services “culminating in transferable property” has been articulated in the context of federal estate and gift taxation. *See, e.g.*, *Comm’r v. Hogle*, 165 F.2d 352 (10th Cir. 1947); BORIS I. BITTKER ET AL., *FEDERAL ESTATE AND GIFT TAXATION* 79-81 (8th ed. 2000).

¹⁶ *See supra* note 15 and accompanying text.

¹⁷ For example, a debtor’s rendition of a service or advice to a third party may result in the creation of a tangible asset in the hands of that party such as cash, securities, works of art, and the like. *See, e.g.*, *Comm’r v. Hogle*, 165 F.2d 352 (10th Cir. 1947); *FEDERAL ESTATE AND GIFT TAXATION*, *supra* note 15, at 79 and accompanying notes.

¹⁸ PETER A. ALCES, *THE LAW OF FRAUDULENT TRANSACTIONS* ¶ 5.01[2][a], at 5-11 (1989) “[T]he first fraudulent disposition statute in the English legal system; it provided the model for fraudulent conveyance law in the United States and continues to have an influence on fraudulent disposition jurisprudence.” *Id.* ¶ 5.01[4][d][i], at 5-21.

¹⁹ *Id.* ¶ 5.01[2][a], at 5-11.

²⁰ *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and its Proper Domain*, 38 VAND. L. REV. 829, 836 (1985). “Hundreds of different mechanisms have evolved—from net worth and accounting requirements to security interests and default clauses—that guard against the risk of unacceptable debtor behavior.” *Id.* (citing generally Robert Charles Clark, *The Duties of the Corporate*

produced a pro-creditor shift in the way courts and legislatures think about fraudulent transfer law.²¹

Part I explores these changes, first by providing background information on the bankruptcy process. Then, it discusses the evolution and purpose of fraudulent transfer law and briefly looks at two main types of fraud: actual and constructive. Finally, it provides an overview of fraudulent transfer law in the context of the Bankruptcy Code²² as well as state law models—the UFTA and the UFCA.

A. *Background and Purpose of Fraudulent Transfer Law*

From the beginning, the Statute of 13 Elizabeth condemned property transfers by the debtor who had an actual intent “to hinder, delay, or defraud” his creditors.²³ Subsequently, the drafters of the Bankruptcy Code expanded fraudulent transfer law to include constructively fraudulent transfers.²⁴ This expansion allowed for automatic application of fraudulent transfer law whenever an insolvent debtor transferred property for inadequate consideration.²⁵ Later, the legislature further broadened the scope of the law by making various amendments to the Bankruptcy Code.²⁶ The most recent of these amendments went into effect on October 17, 2005.²⁷ The 2005 amendments exhibit a pro-creditor sentiment

Debtor to Its Creditors, 90 HARV. L. REV. 505 (1977)). For an extensive overview of these challenges posed by modern transactions, see Jack F. Williams, *Revisiting the Proper Limits of Fraudulent Transfer Law*, 8 BANKR. DEV. J. 55 (1991); Baird & Jackson, *supra*, at 830.

²¹ Williams, *supra* note 20, at 60, 66.

²² 11 U.S.C.S. § 548 (LexisNexis 1997, Supp. 2005 & Supp. 2006).

²³ ALCES, *supra* note 18, ¶ 5.01[4][d], at 5-21.

²⁴ *See id.* ¶ 5.01[2][d], at 5-14.

²⁵ Baird & Jackson, *supra* note 20, at 830.

²⁶ *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), available at <http://www.usdoj.gov/ust/eo/bapcpa/index.htm> [hereinafter BAPCPA].

²⁷ SHEILA M. WILLIAMS ET AL., BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 3 (2005).

Signed into law by President Bush on April 20, 2005, the Bankruptcy Prevention and Consumer Protection Act of 2005 represents the largest overhaul of the Bankruptcy Code since its enactment in 1978. The Act seeks to “improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors.”

The heart of the Act’s consumer bankruptcy reforms consists of the implementation of a “means testing” mechanism that is intended to ensure

by focusing on protecting creditors from debtors' abusive filing practices and discouraging debtors' use of bankruptcy as a means of avoiding their obligations to creditors.²⁸ For example, as of October 17, 2005, creditors can recover not only pre-bankruptcy assets of a Chapter 11 individual debtor but also the assets that the individual debtor acquired after the bankruptcy filing.²⁹ In contrast, before the 2005 amendments, the debtor's property acquired post-petition was not a part of his bankruptcy estate and thus was not available for distribution to his creditors.³⁰ Separately, the new amendments have also lengthened the time period for an individual debtor to obtain a bankruptcy discharge from six to eight years.³¹ In sum, the recent changes to the Bankruptcy Code have strengthened the creditors' power in relation to the debtor's bankruptcy options.

With respect to a typical bankruptcy case, when a debtor files for bankruptcy several interesting things occur. First, commencement of the bankruptcy case creates a bankruptcy "estate" comprised of all of the debtor's property at the time of the filing.³² The instant a debtor files a bankruptcy petition, the debtor's property becomes the property of the estate, which means it no longer belongs to the debtor.³³ Property of the estate is an important concept in bankruptcy because it allows the bankruptcy trustee to liquidate the debtor's nonexempt assets and to distribute those assets to

that debtors repay creditors the maximum debtors can afford. The Act also includes provisions intended to deter serial and abusive bankruptcy filings.

Id. See also Alan N. Resnick & Henry J. Sommer, *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: A Section-by-Section Analysis*, in THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 1-3 (2005).

²⁸ WILLIAMS, *supra* note 27, at 54.

²⁹ BAPCPA § 321(a)(1) (codified at 11 U.S.C.S. § 1115 (LexisNexis Supp. 2006)). Section 1115 of the Bankruptcy Code is a new Chapter 11 business reorganization section for cases filed by individual debtors. See WILLIAMS, *supra* note 27, at 107 ("The provision [§ 1115] also subjects a Chapter 11 discharge for an individual debtor to the same exceptions from discharge that apply to Chapter 7 and Chapter 13 cases.").

³⁰ WILLIAMS, *supra* note 27, at 107.

³¹ 11 U.S.C.S. § 312(1); compare *id.* § 727(a)(8) (LexisNexis 2000), with *id.* § 727(a)(8) (LexisNexis Supp. 2006).

³² *Id.* § 541(a) (LexisNexis 1997).

³³ See *id.* Some estate property may be later returned to the debtor as exempt property under section 522 (LexisNexis 2004 & Supp. 2005) or by abandonment under section 554 (LexisNexis 2004 & Supp. 2005).

creditors in an organized manner.³⁴ Another important consequence of the bankruptcy filing is that it creates an “automatic stay” that stops all individual creditor collection efforts.³⁵ The automatic stay functions as an injunction that temporarily protects the debtor from all creditor actions to collect pre-petition debts.³⁶ The underlying goal of this process is to get an “honest but unfortunate debtor” back on his feet.³⁷

The trustee’s role in the bankruptcy proceeding is manifold. It includes protecting the property of the estate that has been collected for the benefit of creditors.³⁸ In addition, aside from determining whether any property should be removed from the estate and returned to the debtor as exempt property, a trustee may avoid certain property transfers made by the debtor in order to maximize the value of the estate available for distribution to creditors.³⁹ Sections 544 through 551 of the Code provide the bankruptcy trustee with such “avoiding powers,”⁴⁰ including the power to set aside fraudulent transfers.⁴¹

To understand the purposes of fraudulent transfer law, one must look at the underlying policies of bankruptcy. As a collective proceeding, bankruptcy enhances creditor recovery using a presumption of equality among same-situated creditors

³⁴ The trustee is a representative of the bankruptcy estate, *id.* § 323(a) (LexisNexis 2004 & Supp. 2005). See BANKRUPTCY LAW MANUAL ¶ 6.08, at 6-48 (Benjamin Weintraub and Alan N. Resnick eds., Warren, Forham & Lamont 1992). There are several different types of trustees depending on which bankruptcy chapter the case is filed under. See *id.* ¶ 6.08, at 6-49.

³⁵ 11 U.S.C.S. § 362 (LexisNexis 1995, Supp. 2005 & Supp. 2006).

³⁶ BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 1.09[1], at 1-35.

³⁷ *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

³⁸ BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 6.08, at 6-48.

³⁹ *Id.* ¶ 7, at 7-3.

⁴⁰ 11 U.S.C.S. §§ 544-51 (LexisNexis 1997, Supp. 2005 & Supp. 2006). Avoiding powers are powers given to a trustee in bankruptcy to recover property interests for the benefit of all of the debtor’s creditors. BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 7, at 7-3. After the trustee has avoided a property interest, 11 U.S.C.S. § 550, the transfer that created that property interest is “preserved for the benefit of the estate,” *id.* § 551, and any interest in property so recovered becomes the property of the estate, *id.* § 541(a)(3).

⁴¹ 11 U.S.C.S. § 548. While this Note focuses on section 548, the analysis similarly would apply to section 547, which allows the trustee to avoid preferential transfers made shortly before the commencement of the bankruptcy case that otherwise would allow one creditor to claim more than its fair share of the debtor’s assets. *Id.* § 547. Section 547 is intended to assure equality of distribution among same-situated creditors. BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 7.05, at 7-18. See also Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 757 (1984) (“[P]references differ from fraudulent conveyances precisely because preference law focuses on relationships among creditors in light of the advantages of a collective proceeding, not on relationships between creditors and their debtor.”).

as a starting point.⁴² From a creditor's standpoint, the underlying goals of bankruptcy are to deal with the universe of creditors as a whole on an equitable basis and to maximize the value of the estate available for distribution to all creditors.⁴³ In contrast to bankruptcy, state collection law focuses on the rights of an individual creditor whose motivation is to get to the debtor's assets before any other creditor.⁴⁴

In bankruptcy, fraudulent transfer laws allow creditors to set aside certain transfers by debtors that undermine creditors' collection efforts and unfairly diminish the debtor's estate.⁴⁵ A debtor facing imminent economic downfall is more likely to conceal property in an effort to defraud his creditors. The law of fraudulent transfers seeks to prevent precisely these types of actions.⁴⁶

B. *Actual and Constructive Fraud*

There are two major types of fraudulent transfers: actual and constructive.⁴⁷ Classic fraudulent transfer law only dealt with the debtor who intentionally manipulated his assets in order to keep them away from his creditors.⁴⁸ Today, actual fraud remains the basis for avoidance of transfers under section 548(a)(1) of the Bankruptcy Code and requires proof of the subjective intention of the debtor in making a transfer.⁴⁹ For example, a debtor who gives his valuable personal property to a friend on the eve of bankruptcy, so that the creditors do not get it, has made an actual transfer with the "intent to hinder, delay, or defraud [his creditors]."⁵⁰ Constructive fraud, on the other hand, manifests itself through the presence of certain specified facts irrespective of the actual subjective

⁴² BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 7.05, at 7-18.

⁴³ Jackson, *supra* note 41, at 728-29.

⁴⁴ BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 2.02, at 2-4 ("In addition, our system of debt collection is based on "grab law" pursuant to which the first creditors to acquire liens on the debtor's property succeed to the detriment of the remaining creditors who are left empty-handed.")

⁴⁵ GLENN, FRAUDULENT CONVEYANCES, *supra* note 10, § 275.

⁴⁶ ALCES, *supra* note 18, ¶ 5.01[1].

⁴⁷ 11 U.S.C.S. § 548; *see infra* notes 48, 51 and accompanying text.

⁴⁸ Jackson, *supra* note 41, at 778 (citing Clark, *supra* note 20).

⁴⁹ BANKRUPTCY LAW MANUAL, *supra* note 34, ¶ 7.06[1], at 7-58 ("The state of mind of the debtor must be examined in order to determine whether this type of fraud [referring to actual fraud] took place.")

⁵⁰ 11 U.S.C.S. § 548(a)(1)(A).

intention of the debtor.⁵¹ As a result, constructive fraud serves as “a per se rule” of avoidance in cases of alleged fraud where there is little to no apparent evidence of actual wrongdoing.⁵² Even if there is no evidence of a debtor’s misbehavior, some transfers by their very nature make creditors worse off and are thus facially suspect.⁵³ Under this rationale, constructive fraud becomes a creditor’s remedy against the debtor.⁵⁴

C. Current Fraudulent Transfer Laws

Today, fraudulent transfer laws are incorporated in the Bankruptcy Code and the law of every state.⁵⁵ These laws are not identical but they overlap in many respects. Section 548 of the Bankruptcy Code governs avoidance of fraudulent transfers.⁵⁶ State fraudulent law can be invoked under section 544(b) of the Bankruptcy Code.⁵⁷ In addition, individual states follow the UFTA or the UFCA.⁵⁸ Several states, however, have not adopted uniform or even statutory fraud laws and instead deal with fraudulent transfer law as a matter of case law.⁵⁹

⁵¹ *Id.* § 548(a)(1)(B); see also GLENN, FRAUDULENT CONVEYANCES, *supra* note 10, § 275, at 471; § 294, at 510-11; & § 298, at 518.

⁵² Baird & Jackson, *supra* note 20, at 831; see, e.g., *Philco Fin. Corp. v. Pearson*, 335 F. Supp. 33, 40-41 (N.D. Miss. 1971):

Courts often infer a fraudulent intention from circumstances attending a transaction from the presence of certain well-known labels or badges of fraud. These badges of fraud are suspicious circumstances which, if unexplained, warrant an inference of fraud, and the more common badges of fraud were thus enumerated in *Reed v. Lavecchia*, 187 Miss. 413, 193 So. 439 (1940):

“Inadequacy of consideration, transaction not in usual course or mode of doing business, absolute conveyance as security, secrecy, insolvency of grantor, transfer of all his property, attempt to give evidence of fairness by conscripting sister-in-law as a conduit for passing title to the wife, retention of possession, failure to take a list of the property covered by the conveyance which was commingled with some furniture and fixtures belonging to his father’s estate, relationship of the parties, and transfer to person having no apparent use for the property.”

Philco Fin. Corp., 335 F. Supp. at 40-41 (quoting *Lavecchia*, 187 Miss. at 424-25).

⁵³ Baird & Jackson, *supra* note 20, at 831-32.

⁵⁴ See *id.* at 831.

⁵⁵ WM. MILLER COLLIER ET AL., COLLIER ON BANKRUPTCY ¶ 548.01[4], at 548-12 (Alan N. Resnick and Henry J. Sommer, eds., 15th ed. 2006).

⁵⁶ 11 U.S.C.S. § 548.

⁵⁷ *Id.* § 544(b)(1) (LexisNexis Supp. 2005).

⁵⁸ COLLIER ON BANKRUPTCY, *supra* note 55, ¶ 548.01[3], at 548-611.

⁵⁹ See ALCES, *supra* note 18, ¶ 1.02[1][b][i] (“Those states are in the minority, and, in fact, will occasionally refer to the UFCA and cases decided thereunder to resolve fraudulent disposition issues.”).

The UFTA is in many respects similar to section 548 of the Code.⁶⁰ While the legislature originally wanted to replace the UFCA with the UFTA, some states, such as New York, still use the UFCA.⁶¹ For the most part, the drafters of the UFTA tried to provide guidance for potential fraudulent transfer problems in complex transactions.⁶² The UFTA maintained the original definition of an actual fraudulent transfer.⁶³ However, in deciding whether a transferor received value, the UFTA, unlike the UFCA, let go of the “good faith requirement.”⁶⁴ Furthermore, in an effort to make it more difficult to defraud creditors, the UFTA allowed creditors extra relief against recipients of fraudulent transfers.⁶⁵

With respect to the Bankruptcy Code, section 548 is one of the most powerful tools available to a bankruptcy trustee who believes that the debtor made a fraudulent transfer; the trustee may also utilize applicable state law under the “‘strong-arm’ power”⁶⁶ of section 544.⁶⁷ Section 548 is a mechanism to police “fraud and self-dealing by a debtor at the expense of the debtor’s creditors.”⁶⁸ Section 548(a) authorizes the trustee to challenge fraudulent transfers made within two years before the filing of the bankruptcy case.⁶⁹ In part, it provides:

(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 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(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

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

⁶⁰ COLLIER ON BANKRUPTCY, *supra* note 55, ¶ 548.01[3], at 548-611.

⁶¹ N.Y. DEBT. & CRED. LAW §§ 270-81 (McKinney 1990).

⁶² ALCES, *supra* note 18, ¶ 1.02 [1][b][iii].

⁶³ *Id.*

⁶⁴ COLLIER ON BANKRUPTCY, *supra* note 55, ¶ 548.01[3], at 548-611.

⁶⁵ *Id.*

⁶⁶ Jackson, *supra* note 41, at 732.

⁶⁷ “The 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” 11 U.S.C.S. § 544(b)(1) (LexisNexis Supp. 2005).

⁶⁸ *In re Feiler*, 218 F.3d 948, 955 (9th Cir. 2000).

⁶⁹ 11 U.S.C.S. § 548(a)(1) (LexisNexis 1997, Supp. 2005 & Supp. 2006).

(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. . . .⁷⁰

On its face, the Bankruptcy Code restricts fraudulent transfer law to a transfer of an interest in property.⁷¹ Thus, a creditor seeking to avoid any type of fraudulent transfer, actual or constructive, must show that a debtor made a transfer of property and not merely a transfer of services.⁷² *Black's Law Dictionary* defines property as "the right of ownership"⁷³ and defines services as "[a]n intangible commodity in the form of human effort, such as labor, skill, or advice."⁷⁴ Accordingly, when a reasonable person thinks about property, he or she considers "whether it can be assigned, sold, transferred, conveyed, or pledged, or whether it terminates on the death of the owner."⁷⁵ If services are something "personal to the holder,"⁷⁶ which terminate at death and are not inheritable, then those services have no proprietary attributes in the traditional sense of the term.⁷⁷ Unlike *Black's Law Dictionary*, the Bankruptcy Code does not define the term property or services.⁷⁸ As a result, this lack of definition leaves ample room for further expansion of fraudulent transfer law. In fact, it allows courts to maneuver on a case-by-case basis to determine whether services should be deemed property in the fraudulent transfer context.

II. SHOULD SERVICES BE DEEMED PROPERTY?

Under the current Bankruptcy Code and existing case law, it is unclear whether a debtor's creditors can recover the

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ BLACK'S LAW DICTIONARY, *supra* note 7, at 1232.

⁷⁴ *Id.* at 1372.

⁷⁵ *In re Marriage of Graham*, 574 P.2d 75, 77 (Colo. 1978) (citing *In re Marriage of Ellis* (Colo. Ct. App. 1975), 538 P.2d 1347, *aff'd sub nom.*, *Ellis v. Ellis*, 552 P.2d 506 (Colo. 1976)).

⁷⁶ *Id.*

⁷⁷ *Id.* (deciding that an M.B.A. was not "property" for purposes of dissolution of a marriage).

⁷⁸ The UFTA defines "property" as "anything that may be the subject of ownership." UFTA § 1(10) (1984). The comment to the UFTA further explains that "property includes both real and personal property, whether tangible or intangible, and any interest in property, whether legal or equitable." *Id.* § 1, cmt. (10).

fair market value of the debtor's services provided to a third party. If courts were to classify services as property for the purpose of fraudulent transfer law, then creditors could recover the fair market value of such services from third party recipients. However, if courts were to leave property and services to their traditional definitions, then the value of such services would be out of creditors' reach. Part II addresses central considerations that must be taken into account when deciding whether services should be deemed property. First, it discusses the intricacies of fraudulent transfer law under section 548 of the Bankruptcy Code. Then, it describes how the concept of property has been applied in a bankruptcy setting. Finally, it examines the concept of property in other contexts and considers the implications of reclassifying services as property in the context of fraudulent transfer law.

A. *Fraudulent Transfers: An Overview of Section 548*

The bankruptcy law balances debtor and creditor rights with the goal of accomplishing an equitable allocation of assets.⁷⁹ Under section 548 of the Bankruptcy Code, a bankruptcy trustee may recover property for the bankruptcy estate if (1) there was a transfer, (2) of a debtor's interest in property, (3) made on or within two years before the debtor's bankruptcy petition.⁸⁰ One of the essential elements for setting a transfer aside under section 548(a)(1)(A) is the debtor's subjective fraudulent intent which can be established by circumstantial acts.⁸¹ On the other hand, section 548(a)(1)(B) deals with constructively fraudulent transfers, thereby asserting that a transfer is not constructively fraudulent if the debtor received adequate consideration.⁸²

⁷⁹ ALCES, *supra* note 18, ¶ 1.03[2].

⁸⁰ 11 U.S.C.S. § 548(a), (b) (LexisNexis 1997, Supp. 2005 & Supp. 2006).

⁸¹ COLLIER ON BANKRUPTCY, *supra* note 55, ¶ 548.04[1], at 548-22.3; *see also* 11 U.S.C.S. § 548(a)(1)(A).

⁸² 11 U.S.C.S. § 548(a)(1)(B). Unlike the UFCA, the Code's adequate consideration requirement does not contain a good faith component. COLLIER ON BANKRUPTCY, *supra* note 55, ¶ 548.05[1][b]. However, "[a]lthough good faith is not an element of the [Bankruptcy Code's] section 548(d)(2) definition of 'value', the bad faith of a transferee may still result in the setting aside of a transfer if the transferee's bad faith can be imputed to the transferor so that the transferor actually intended 'to hinder, delay, or defraud' creditors." *Id.* For the purposes of section 548, "value" means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C.S. § 548(d)(2)(A).

Thus, to determine whether a fraudulent transfer has occurred, courts must address several issues. First, a bankruptcy trustee who is seeking to avoid any type of fraudulent transfer must prove that a “transfer” has occurred. The Bankruptcy Code defines “transfer” in section 101(54) as “each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (i) property, or (ii) an interest in property.”⁸³ The court must also determine the time of the transfer since a fraudulent transfer may only be set aside if it “was made or incurred on or within 2 years before the date of the filing of the petition.”⁸⁴ Once a party seeking to invalidate the transfer proves that a “transfer” was made, it also has to show that the transfer involved the debtor’s “property.”⁸⁵ However, unlike the term “transfer,” bankruptcy law does not provide for an exhaustive or uniform understanding of the term “property.”⁸⁶ In searching for the meaning of this term, courts often refer to “commercial sense and pertinent state law property concepts.”⁸⁷

B. *The Concept of Property in Bankruptcy*

The Statute of Elizabeth limited the concept of property to tangible assets.⁸⁸ Today, however, creditors can recover tangible or intangible property.⁸⁹ In order to maximize creditors’ remedies, the courts have breathed elasticity into the term “property.”⁹⁰ Generally, it includes “anything of value, anything which has debt paying or debt securing power.”⁹¹ In *Segal v. Rochelle*, the Supreme Court explained that the purpose of construing the term “property” broadly is

to secure for creditors everything of value the [debtor] may possess in alienable or leivable form when he files his petition. To this end, the term ‘property’ has been construed most generously and an

⁸³ 11 U.S.C.S. § 101(54).

⁸⁴ *Id.* § 548(a)(1). But see the new § 548(e)(1), which provides a trustee with a ten year limitation period to avoid a debtor’s transfer made “to a self-settled trust or similar device.” *Id.*

⁸⁵ *Id.*

⁸⁶ See discussion *infra* Part II.B. and accompanying notes.

⁸⁷ ALCES, *supra* note 18, ¶ 6.02[1][b].

⁸⁸ GLENN, FRAUDULENT CONVEYANCES, *supra* note 10, § 135.

⁸⁹ *Id.* § 138.

⁹⁰ *Segal v. Rochelle*, 382 U.S. 375, 379 (1966); *In re Lewis W. Shurtleff, Inc.*, 778 F.2d 1416, 1419 (9th Cir. 1985).

⁹¹ *Pirie v. Chicago Title & Trust Co.*, 182 U.S. 438, 443 (1901).

interest is not outside creditors' reach just because it is novel or contingent or because enjoyment must be postponed.⁹²

While the Bankruptcy Code does not contain a definition of property, it also does not explicitly exclude services from being classified as property. Although this decision is ultimately left to judicial analysis and interpretation, the lack of any definition leaves courts to many interpretive possibilities. The very fact that the traditional concepts of property and services are dissimilar at first glance may allow courts to recognize overarching interpretations when analyzing these concepts. Currently, however, there is little case law dealing with the question of whether services could be considered property in the fraudulent transfer context. Accordingly, marital law cases offer some relevant examples.

C. Property in Other Contexts: Learning From Marital Law Cases

In marital cases, courts have often crossed the bridge from the traditional definition of property to a more liberal construction of an asset in question in order to achieve an equitable result.⁹³ For example, courts have viewed a medical degree or a celebrity's career as property eligible for equitable distribution.⁹⁴ In the decisions that follow, the judicial perception of marital property invariably stems from the view that the institution of marriage is "an economic partnership."⁹⁵ As such, it involves a specific exchange of tangible and intangible resources, which must be accounted for upon divorce.⁹⁶ In adopting an equitable approach to such an analysis, the courts ultimately move away from formal or traditional definitions of property in order to include such

⁹² *Segal*, 382 U.S. at 379.

⁹³ *Archer v. Archer*, 493 A.2d 1074, 1077-78 (Md. 1985).

⁹⁴ See discussion *infra* notes 97-130 and accompanying text. Marital property is defined broadly as "all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action, regardless of the form in which title is held." *O'Brien v. O'Brien*, 489 N.E.2d 712, 715 (N.Y. 1985).

⁹⁵ *Forcucci v. Forcucci*, 443 N.Y.S.2d 1013, 1015 (App. Div. 1981) ("The Equitable Distribution Law was enacted as the result of a growing realization that the marriage relationship is also an economic partnership and that when a marriage ends there should be some comprehensive and fair approach to the economic incidents of divorce.").

⁹⁶ *Id.*

intangible assets like professional degrees and careers under the property umbrella.

To begin, in *O'Brien v. O'Brien*,⁹⁷ the New York Court of Appeals held that a husband's medical degree obtained during his marriage could be marital property subject to equitable distribution upon divorce.⁹⁸ In that case, the parties were married for almost ten years.⁹⁹ During that period, the couple's efforts were primarily focused on obtaining the husband's medical degree.¹⁰⁰ In fact, while the husband was in the process of obtaining his medical degree, the wife worked to support both of them instead of pursuing her permanent teaching certification.¹⁰¹ After completing his undergraduate degree and premedical requirements, the O'Briens relocated to Guadalajara, Mexico, where Mr. O'Brien attended medical school.¹⁰² During this time, Mrs. O'Brien continued to work to support them financially.¹⁰³ The parties later returned to New York so that Mr. O'Brien could complete his degree program and internship.¹⁰⁴ Two months after Mr. O'Brien received his license to practice medicine, he filed for divorce.¹⁰⁵

At the divorce proceeding, Mr. O'Brien argued that his medical degree was not property but rather a "personal attainment in acquiring knowledge."¹⁰⁶ The Court of Appeals disagreed explaining that traditional common law property doctrine does not constrain the definition of marital property.¹⁰⁷ Indeed, the court reasoned that although a degree does not render itself to "sale, assignment or transfer," it still might be "property" under the New York divorce statute.¹⁰⁸ In the court's opinion, the New York statutory law with respect to marital property easily accommodated inclusion of a medical degree.¹⁰⁹ Further, the court noted that the statute's economic partnership theory required classification of career assets as

⁹⁷ 489 N.E.2d 712 (N.Y. 1985).

⁹⁸ *Id.* at 713.

⁹⁹ *See id.* at 713-14.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.* at 714.

¹⁰³ *O'Brien*, 489 N.E.2d at 714.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 715.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 717 ("That a professional license has no market value is irrelevant.").

¹⁰⁹ *O'Brien*, 489 N.E.2d at 715.

marital property subject to equitable distribution.¹¹⁰ In sum, the *O'Brien* court, through the use of equity and with the goal of doing justice for the suffering spouse, went beyond the traditional definition of property in order to enlarge the marital estate.

Hence, in *Golub v. Golub*,¹¹¹ a New York trial court held that a spouse's celebrity career, similar to a professional degree, represents marital property upon divorce.¹¹² In *Golub*, a famous actress and model, Marisa Berenson, married an established attorney.¹¹³ After four and a half years of marriage, the couple divorced.¹¹⁴ Throughout the marriage, Ms. Berenson was focused on advancing her career.¹¹⁵ She spent a lot of time abroad, during which time Mr. Golub took care of their home.¹¹⁶ At the divorce proceeding, Mr. Golub argued that the increase in value of his spouse's acting and modeling career was marital property, subject to equitable distribution upon divorce.¹¹⁷ The court sided with Mr. Golub, rejecting Ms. Berenson's arguments "that her celebrity status is neither 'professional' nor a 'license' and hence not an 'investment in human capital subject to equitable distribution.'"¹¹⁸ In deciding the issue, the court referred to *O'Brien v. O'Brien*, in which the Court of Appeals held that a professional license constituted marital property.¹¹⁹ The *Golub* court concluded that "[t]he *O'Brien* remedy should be applied evenhandedly to all spouses," professional and nonprofessional alike,¹²⁰ justifying its decision by the need to avoid "an economic windfall to some and an

¹¹⁰ *Id.* at 716. The court stated:

The Legislature has decided, by its explicit reference in the statute to the contributions of one spouse to the other's profession or career, that these contributions represent investment in the economic partnership of the marriage and that the product of the parties' joint efforts, the professional license, should be considered marital property.

Id.

¹¹¹ 527 N.Y.S.2d 946 (Sup. Ct. 1988).

¹¹² *Id.* at 950.

¹¹³ *Id.* at 947.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 948.

¹¹⁶ *Id.*

¹¹⁷ *Golub*, 527 N.Y.S.2d at 949.

¹¹⁸ *Id.* at 949.

¹¹⁹ 489 N.E.2d 712 (N.Y. 1985). See *supra* notes 97-110 and accompanying text.

¹²⁰ *Golub*, 527 N.Y.S.2d at 950.

unfair deprivation to others.”¹²¹ The court noted that marital property should not be constrained to “licenses enumerated in the Education Law.”¹²² It further held that “the skills of an artisan, actor, professional athlete or any person whose expertise in his or her career has enabled him or her to become an exceptional wage earner should be valued as marital property subject to equitable distribution.”¹²³

In another case, *Elkus v. Elkus*, a famous opera singer, Frederica von Stade, filed for divorce after a seventeen-year marriage.¹²⁴ During the course of the marriage, Ms. von Stade reached the apex of her career.¹²⁵ Her husband alleged that he contributed to his wife’s success, and therefore, her career should be shared as marital property.¹²⁶ The appellate court agreed with Mr. Elkus, holding that under the New York definition, “things of value acquired during marriage are marital property even though they may fall outside the scope of traditional property concepts.”¹²⁷ The court further stated that “[t]he statutory definition of marital property does not mandate that it be an asset with an exchange value or be salable, assignable or transferable.”¹²⁸ Thus, the court found no reason why it could not extend the *O’Brien* rule to a celebrity career. The *Elkus* court followed *Golub’s* reasoning, noting that “[t]here is no rational basis upon which to distinguish between a degree, a license, or any other special skill that generates a substantial income.”¹²⁹ Therefore, because defendant contributed to the advancement of Ms. von Stade’s career, such advancement constituted marital property.¹³⁰

In the marital context, because courts recognize that the supporting spouse suffers inequity and unfairness upon divorce, the courts choose to even the score between the spouses by declaring intangible assets such as professional degrees and celebrity careers to be marital property.¹³¹ This

¹²¹ *Id.*

¹²² *Id.* at 949.

¹²³ *Id.* at 950.

¹²⁴ 572 N.Y.S.2d 901 (Sup. Ct. 1991).

¹²⁵ *Id.* at 902.

¹²⁶ *Id.*

¹²⁷ *Id.* (citing *O’Brien v. O’Brien*, 489 N.E.2d 712 (N.Y. 1985)).

¹²⁸ *Id.* at 902.

¹²⁹ *Id.* at 904.

¹³⁰ *Elkus*, 572 N.Y.S.2d at 904.

¹³¹ *See, e.g., O’Brien*, 489 N.E.2d at 716-17 (noting that it is “unfair not to consider the license a marital asset” in light of the fact that “[w]orking spouses are

inequity is especially acute where the supporting spouse purposely puts the development of his or her own career on hold. By analogy, a creditor, like a supporting spouse, also suffers inequity and unfairness when a debtor breaks his contractual obligations and leaves his creditor empty-handed. In the fraudulent transfer context, this inequity manifests itself where the debtor purposely transfers assets on the eve of bankruptcy so that his creditors get nothing. Thus, the equitable analysis employed by the marital courts may also be applied to the concept of services in the bankruptcy context. Specifically, instead of being bound by the traditional concepts of property, bankruptcy courts can choose to construe the term “property” in such a way as to include services under its umbrella. This approach would maximize the value of the debtor’s estate, thus providing a powerful remedy to the debtor’s creditors. Otherwise, if services cannot be considered property, it might allow disinterested debtors to manipulate the bankruptcy process in order to deprive creditors of a valuable asset.

As the above examples demonstrate, from time to time, courts do assign property-like characteristics to services.¹³² And if disputes are to be resolved with respect to services, reference to property law second to contract law¹³³ would probably be most helpful. However, not every fraudulent transfer case involving services should be subject to propertization. Instead, bankruptcy courts should selectively recognize only certain attributes of services as property. Through this selective approach, courts can achieve the underlying bankruptcy goals without infringing on the debtor’s rights or the rights of third parties.

III. A SELECTIVE APPROACH TO THE UNION OF SERVICES AND PROPERTY

Services should not be deemed property in the fraudulent transfer context unless such services “culminate in

often required to contribute substantial income as wage earners, sacrifice their own educational or career goals and opportunities for child rearing, perform the bulk of household duties and responsibilities and forego the acquisition of marital assets that could have been accumulated if the professional spouse had been employed rather than occupied with the study and training necessary to acquire a professional license”).

¹³² See *supra* Part II.C.

¹³³ Baird & Jackson, *supra* note 20, at 835-36.

transferable property.”¹³⁴ Accordingly, the equitable approach to defining property used by marital courts, as illustrated in Part II.C., may not be appropriate in all fraudulent transfer situations. Considering that there is no real check on overexpansion of what is to be considered property due to lack of precise definitions, any attempt to liberally apply fraudulent transfer law to services can create a dangerous precedent. For example, application of the equitable approach would be inappropriate in our Jones hypothetical because the “asset” at issue, i.e., the health benefit to the patient, is unquantifiable. Therefore, courts should be selective in classifying services as property in the fraudulent transfer context.

Part III discusses specific fraudulent transfer situations where the equitable approach may be appropriate for resolving fraudulent transfers. In addition, it explains the “underlying chattel” theory through case law and contrasts it with the equitable approach. Finally, it concludes that all services cannot be simply classified as property and argues for an application of a selective approach to services in the fraudulent transfer context.

A. *The Union of Services and Property*

Expanding the formal definition of property to services under the equitable approach may be justified in transfers made with actual fraudulent intent, as opposed to constructive intent. Indeed, where a debtor is intentionally trying to delay or hinder his creditors’ ability to collect on the owed debt, the chances are that the debtor and the third party are not entirely blameless. For example, Picasso may agree to paint the neighbor’s picture on the eve of bankruptcy with the understanding that the neighbor will pay Picasso for the portrait once Picasso is out of bankruptcy. In such a case, the court should be able to view Picasso’s services as property regardless of whether a contractual agreement can be proven, and recover the painting from the neighbor for the benefit of creditors.¹³⁵ However, in a constructively fraudulent scenario,

¹³⁴ See *supra* note 15 and accompanying text.

¹³⁵ Section 541 of the Bankruptcy Code includes in the property of the estate “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C.S. § 541(a)(1) (LexisNexis 1997). Thus, if it can be established that Picasso and the neighbor entered into a contract before Picasso’s filing of bankruptcy, the neighbor’s subsequent payment would become property of the estate based on the contractual obligation.

where a debtor provides uncompensated services without any intent to defraud his creditors, the use of the equitable approach is too overreaching and may allow creditors to get a windfall at the expense of an innocent third party.

Therefore, as an alternative to the equitable approach, bankruptcy courts should include services under the property umbrella only if the services “culminate in transferable property.”¹³⁶ Instructive on this point is *American National Red Cross v. ASD Specialty Healthcare*,¹³⁷ in which the Supreme Court of Alabama looked to the underlying nature of the service—as chattel—to conclude that it constituted property for the purpose of fraudulent transfer law.¹³⁸ In that case, the court held that blood products qualify as “property” under the Alabama Uniform Fraudulent Transfer Act (AUFTA), even though the Alabama’s Uniform Commercial Code specifically termed “the act of procuring and furnishing the blood products” to be a service.¹³⁹ In *ASD Specialty Healthcare*, the plaintiff’s cause of action arose from a contract it had with the defendants.¹⁴⁰ This contract concerned sale of blood products.¹⁴¹ As one of its allegations, the plaintiff contended that one of the defendants engaged in conduct which violated AUFTA. Specifically, the conduct involved transfer of blood products.¹⁴² In rebuttal, the defendants argued that the statute was not applicable since “the blood products in question are considered, for all purposes, to be a ‘service’ under the [Alabama’s Commercial Code] and, therefore, not ‘property’ under the AUFTA.”¹⁴³ Indeed, Alabama’s Uniform Commercial Code provided in part that:

Procuring, furnishing, donating, processing, distributing, or using human whole blood, plasma, blood products, blood derivatives, and other human tissues such as corneas, bones or organs for the purpose of injecting, transfusing, or transplanting any of them in the

¹³⁶ “The purpose of the [Alabama Uniform Transfer Act] is to prohibit fraudulent transfers of property by a debtor who intends to defraud creditors by placing assets beyond their reach.” *Thompson Props. v. Birmingham Hide & Tallow Co.*, 839 So. 2d 629, 632 (Ala. 2002).

¹³⁷ 888 So. 2d 464 (Ala. 2004).

¹³⁸ *Id.* at 466.

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 465.

¹⁴¹ *Id.*

¹⁴² *Id.* “A default judgment has previously been entered against LA Pharamceutical and Peter Woolley, neither of which are defendants in this current action.” *Id.*

¹⁴³ *ASD Specialty Healthcare*, 888 So. 2d at 465.

human body is declared for all purposes to be the rendition of a service by every person participating therein and whether any remuneration is paid therefore is declared not to be a sale of such whole blood, plasma, blood products, blood derivatives, or other human tissues.¹⁴⁴

Referencing the statute, the Alabama Supreme Court agreed with the plaintiff that blood products were property for purposes of AUFTA, explaining that “the *act* of procuring and furnishing the blood products—not the blood products themselves”—constituted a service in this instance.¹⁴⁵ The court distinguished between “the *act* of procuring and furnishing blood products” and the underlying blood products themselves, thereby concluding that since blood products can be owned, they are property for purposes of AUFTA.¹⁴⁶

Although the state statute in *ASD Specialty Healthcare* defined furnishing of blood as a service, the court looked to the “underlying chattel” nature of this service in order to conclude that the transfer was, after all, the transfer of property and thus subject to fraudulent transfer law.¹⁴⁷ Just like the *ASD Specialty Healthcare* case, our earlier hypotheticals illustrate the “underlying chattel” approach. Recall that Warren Ruffet’s neighbor quadrupled her wealth as a result of Ruffet’s free investment advice. Hence, Ruffet’s uncompensated services should justifiably become property of his bankruptcy estate available for distribution to creditors; since the service itself cannot be recovered from a practical standpoint, a creditor can recover the underlying property of that service or the money from the sale of stock. Similarly, and even more to the point, Picasso, who paints a portrait for his neighbor for free, has given his neighbor a wealth-producing piece of property, while depriving his own creditors of a valuable asset. Although the act of painting constituted a service, the painting itself is

¹⁴⁴ ALA. CODE § 7-2-314(4) (LexisNexis 2002).

¹⁴⁵ *ASD Specialty Healthcare*, 888 So. 2d at 466.

¹⁴⁶ *Id.* at 466. However, the dissenting Justices noted that the transaction at issue should not be considered “property” under AUFTA for several reasons. First, Justice Lyons refused to focus exclusively on the nature of the blood products apart from the acts of procuring or furnishing blood products in light of the “all purposes” language of the statute. *Id.* at 467 (Lyons, J., dissenting). Second, Justice Houston distinguished between the actual rendition of a service, which cannot be the subject of ownership and service contracts, which like property, can be owned. *Id.* at 470 (Houston, J., dissenting from denial of application for rehearing). Third, Justice Houston also argued that once Woolley had distributed the blood products to the defendants, the service was complete and could not be transferred or be the subject of ownership. *Id.*

¹⁴⁷ *Id.* at 466 (majority opinion).

property. Thus, even if the neighbor subsequently sold the painting to someone else, creditors should be able to recover the full value of the painting from the neighbor.

In both of these instances, the “underlying chattel” theory would force the neighbors to disgorge to the bankruptcy trustee the fair market value of services that they have received. This conclusion springs from the well-established rationale behind constructively fraudulent transfers for inadequate consideration: that the debtor has a moral duty to give priority to his legal obligations, i.e., his creditors, before attending to his own or anyone else’s interests.¹⁴⁸ In short, a fraudulent transfer is a “wrong” against creditors.¹⁴⁹

In contrast to the Ruffet and Picasso hypotheticals, however, it is difficult to imagine how Tom Jones’ services could be deemed property for the purposes of fraudulent transfer law. This is because Jones’ services lack the “underlying chattel” quality in the sense that they did not result in transferable property. Indeed, Jones simply restored his patient’s physical appearance and well-being. Hence, while Ruffet’s business acumen and Picasso’s skill “culminated in transferable property” that can be valued, Jones’ services resulted in a health benefit, which is impossible to quantify.¹⁵⁰ The conventional wisdom regards a person’s health as priceless. Moreover, while Ruffet and Picasso can actually retrieve the product or the proceeds of their services from their neighbors, Jones cannot go back and demand the return of the patient’s restored physical appearance and well-being.¹⁵¹

As the above examples illustrate, the line between services and property gets more distorted as one distinguishes between tangible and intangible benefits. Generally, a person’s uncompensated services may “culminate” in significant economic advantage to the recipient, a valuable non-economic benefit, or even both. But why should a recipient of a wealth-producing service be forced to disgorge the fair market value of the benefit received, while the recipient of a non-economic benefit should not? Perhaps the chances of fraud are higher

¹⁴⁸ Clark, *supra* note 20, at 510-11. “The ideal can be captured by a cliché: be just before you are generous.” *Id.* at 510.

¹⁴⁹ *Id.*; see also John C. McCoid II, *Constructively Fraudulent Conveyances: Transfers for Inadequate Consideration*, 62 TEX. L. REV. 639, 656 (1983).

¹⁵⁰ See *supra* note 15 and accompanying text.

¹⁵¹ Here, we are not concerned with other means of collecting from the patient, i.e., recovery of fair market value of the surgery performed.

where a debtor has wealth-producing abilities but directs such abilities toward third parties instead of his creditors. In bankruptcy, creditors should take priority over the residue of the debtor's assets because it is only fair that they get something back for what they originally gave to the debtor.¹⁵² Thus, the contractual nature of the debtor-creditor relationship justifies the conclusion that a recipient of services which "culminate in transferable property" should be forced to disgorge the benefit for the sake of the debtor's creditors.

B. A Selective Approach: The "Underlying Chattel" Theory

The "underlying chattel" approach supports our Ruffet and Picasso hypotheticals without posing any subjective inquiry difficulties or valuation problems in the fraudulent transfer context. Surely, so long as services "culminate in transferable property," such property can be fairly valued and the transfer can be avoided under fraudulent transfer law.¹⁵³ Without question, most creditors would welcome the "underlying chattel" theory in the fraudulent transfer context, especially because an insolvent debtor is often uninterested in maximizing assets for his creditors' benefit. In fact, "after a debtor has borrowed money, his interests conflict with those of his creditors."¹⁵⁴ Therefore, the "underlying chattel" approach may provide creditors with assurance that they would get what they bargained for with the debtor.

At the same time, courts should not include services that do not "culminate in transferable property" under a "broad" definition of property.¹⁵⁵ For one, from a debtor's perspective, equating services with property may have drastic implications. Current fraudulent transfer law is designed to be pro-creditor.¹⁵⁶ Thus, in a case of an innocent debtor, fraudulent transfer law opens itself up to the possibility of

¹⁵² Garrard Glenn, *The Diversities of the Preferential Transfer: A Study in Bankruptcy History*, 15 CORNELL L.Q. 521, 525 ("The whole presupposition of the rules against fraudulent conveyances is that from the time a debtor knows that he is insolvent he holds all his property subject to the interests of his creditors." (quoting *In re Salmon*, 239 Fed. 413, 415 (S.D.N.Y. 1916) (Hand, J.))).

¹⁵³ See *supra* note 15 and accompanying text.

¹⁵⁴ Baird & Jackson, *supra* note 20, at 833.

¹⁵⁵ See *supra* note 15 and accompanying text.

¹⁵⁶ Jackson, *supra* note 41, at 783. "[T]he [existing fraudulent] conveyance statutes generally focus on conveyances by the debtor, not on unilateral actions taken by creditors (such as foreclosure sales)." *Id.* at 783 n.184.

abuse by creditors.¹⁵⁷ Even though the main purpose of fraudulent transfer law is to prevent a debtor from defrauding his or her creditors, it is possible for creditors to enrich themselves through the machinery of fraudulent transfer law.¹⁵⁸ Sewer service¹⁵⁹ is just one of many examples of creditors' unethical behavior. Thus, if courts were to start equating services with property in fraudulent transfer cases, an already vulnerable debtor would be placed at a disadvantage. Specifically, a debtor's ability to find or maintain a job may be impaired as a result. For example, an employer, upon checking a potential employee's credit and finding that it is less than perfect, may be hesitant to extend an employment offer to the debtor. Indeed, the employer may be wary of potential liability for additional payments to employee's creditors for the services provided, if the debtor files for bankruptcy. Moreover, an employee debtor may have less negotiating power with respect to his job. For example, if the debtor prefers to take a smaller pay in exchange for other benefits like a reduced hour schedule or a chance to work from home, the debtor's inability to do so may lead to issues of indentured servitude for the sake of creditors.¹⁶⁰ The employer may refuse to honor the employee's request simply because a bankruptcy trustee may later come after the employer for the full payment of the employee's services. Alternatively, it may discourage debtors from being productive in society upon realization that performance of uncompensated services may actually cost money to their service recipients.

Another reason for services not to be classified as property is that, if services are considered property, creditors may get more than they are entitled to at the expense of third party recipients. The basic principle behind fraudulent conveyance law is that creditors are prejudiced only by a transfer of an interest in property that actually belonged to the debtor and which would have been available to creditors

¹⁵⁷ *Id.* at 783-84.

¹⁵⁸ *Id.* at 780.

¹⁵⁹ Sewer service is defined as "[t]he fraudulent service of process on a debtor by a creditor seeking to obtain a default judgment." BLACK'S LAW DICTIONARY, *supra* note 7, at 1372.

¹⁶⁰ GLENN, FRAUDULENT CONVEYANCES, *supra* note 10, § 212. "We have seen that the debtor's labour is not an asset for his creditors, since otherwise our law would sanction slavery." *Id.*

outside of bankruptcy.¹⁶¹ If the debtor chose to provide uncompensated services that is the debtor's choice, and the extra money that the debtor chose not to receive should not be available for creditors since the debtor would have never had that money to begin with. Surely, performance of services by the debtor is generally not a transfer of the debtor's interest in property because the resulting benefit to the third party typically would not become an estate asset and thus would not be available for distribution to creditors.¹⁶² Furthermore, creditors are often sophisticated parties who can protect themselves by either not lending or in the alternative, charging an even higher interest rate. Thus, fraudulent transfer law should not give creditors an additional advantage, especially when the debtor is already in a vulnerable situation.

Aside from a debtor perspective, there are significant third party issues here as well. For example, a third party recipient may not even know that the debtor is about to file bankruptcy; yet, by simply accepting the service, the third party recipient subjects itself to the bankruptcy court's discretion. How much emphasis should a court place on the actual prejudicial effect of the transaction on a third party-transferee? Perhaps one can accept that Ruffet's and Picasso's neighbors would have to disgorge the benefit received, especially since they have paid very little for it. In that respect, Ruffet's and Picasso's creditors may be able to use a constructive trust remedy to cure the unjust enrichment.¹⁶³ Indeed, whenever one, innocently or not, obtains title to property that results in unjust enrichment, courts may declare that such a title-holder is the trustee of a trust, whose sole duty is to transfer the title and possession to the beneficiary.¹⁶⁴ Here, Ruffet's and Picasso's neighbors did not pay for the property which they acquired through these services. In this

¹⁶¹ See *ALCES*, *supra* note 18, ¶ 6.02[1][b], at 6-4 to -5. "Equitable distribution of a debtor's estate is compromised by transactions that divest the debtor of property that would otherwise be available to satisfy the claims of the debtor's general creditors." *Id.*

¹⁶² GLENN, *FRAUDULENT CONVEYANCES*, *supra* note 10, § 212.

¹⁶³ "Constructive trusts are created by courts of equity whenever title to property is found in one who in fairness should not to be allowed to retain it." GEORGE T. BOGERT, *TRUSTS*, § 77, at 286 (6th ed. 1987). Constructive trust is not an express trust but a judicial fiction created to rectify fraud. *Id.* § 77, at 287. In that respect, "[i]t is not a trust in which the trustee . . . ha[s] duties of administration . . . , but rather [the trust is] a passive, temporary trust, in which the trustee's sole duty is to transfer the title and possession [of property] to the beneficiary." *Id.*

¹⁶⁴ *Id.* § 77, at 286.

instance, courts can force them to disgorge the benefits in favor of the debtors' creditors. Under the constructive trust remedy, courts would consider third party recipients to be trustees and order them to transfer title and possession to the beneficiaries, i.e., the debtors' creditors.¹⁶⁵ The reason the constructive trust remedy is available to creditors here is because Ruffet's and Picasso's services created tangible property. Generally, "[a] constructive trust must have definite subject matter, just as an express trust must meet this requirement."¹⁶⁶

However, creditors cannot use the constructive trust remedy with respect to Jones' patient. Recall that Jones conferred a health benefit on his patient as opposed to property. Without question, it is difficult to accept that Jones' patient, who now may have a chance to lead a normal life, should be liable to Jones' creditors. Not only is it illogical to conclude that Jones unjustly enriched his patient, but it is also impractical to demand disgorgement of this benefit. If an innocent third party can be made to pay to the debtor's creditors for such an unquantifiable benefit, it is then the third party, not the debtor, who would feel the wrench of bankruptcy.¹⁶⁷ Surely, Jones' patient did not bargain for such an outcome.

Separately, while the debtor-creditor relationship is typically based on contract, the contractual nature is not present between creditors and third party recipients.¹⁶⁸ Due to this lack of privity, the bankruptcy courts should not look to the third party in order to make the debtor's creditors whole. Indeed, the law governing the debtor-creditor relationship did not intend for a creditor to subject a third party to a fraudulent

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 288.

¹⁶⁷ McCoid, *supra* note 149, at 657-58. "[T]ransferees, not debtors, bear the brunt of invalidation of fraudulent conveyances." *Id.* at 658.

¹⁶⁸ GLENN, FRAUDULENT CONVEYANCES, *supra* note 10, § 140. In his discussion of creditor rights with respect to debtor's services, Glenn points out:

True, the person for whom the debtor gratuitously labored has been enriched, as may be seen in the enhanced value of the property upon which the efforts were expended. But the legislation in which we are interested was never intended to bring creditor and third party into a quasi-contractual relation generally. The inquiry is, what asset, if any, has the debtor transferred to the third party? In the case of gratuitous labor, the answer must be that no asset has passed; hence the creditor cannot subject the third party to any claim under the statutes.

Id.

transfer claim.¹⁶⁹ From a practical standpoint, analyzing third party transactions would probably require courts to return to subjective intent considerations. For example, courts may have to analyze whether the third party was “innocent” or whether he or she knew exactly what was going on when he or she accepted the services from the debtor. However, under the selective approach, the inquiries into the third party’s psyche are unnecessary. Regardless of whether the third party knew of the debtor’s motivations to file for bankruptcy, it would have to disgorge the value of the services received if the services “culminated into transferable property.”¹⁷⁰ Under this approach, because tangible benefits have clearly assignable values, creditors can easily recover assets under the constructive trust remedy, without any practical difficulties.

Considering that the historical progression of fraudulent transfer law has been toward development of objective criteria,¹⁷¹ courts should be disinclined to classify all services as property for the sake of judicial efficiency. In that respect, the selective approach to the joinder of services and property limits the potential abuse and misapplication of fraudulent transfer law, while providing creditors with a workable remedy.

CONCLUSION

The concept of fraud is difficult to pigeonhole into one set of rules. On the one hand, leaving the term property to its traditional meaning undermines the Code’s underlying policy of enhancing creditors’ recovery. On the other hand, classifying all services as property expands a creditor’s advantage at the debtor’s and third party’s expense. As this Note demonstrates, however, a selective approach to this inquiry could still fulfill bankruptcy goals without sacrificing judicial efficiency and equitable treatment of the parties involved.

Through the selective approach, bankruptcy courts can achieve the mission of protecting the debtor’s assets for creditors without reducing fraudulent transfer law to a profit-generating tool. Indeed, if a debtor possesses skills that can

¹⁶⁹ Baird & Jackson, *supra* note 20, at 835-36.

¹⁷⁰ See *supra* note 15 and accompanying text.

¹⁷¹ ALCES, *supra* note 18, ¶ 5.02 (stating that “[c]ourts have trouble reaching reliable conclusions regarding subjective matters; therefore there was a need to objectify fraudulent disposition law”).

produce an economic benefit, he should direct his efforts to using those skills to pay off his creditors, as opposed to rendering potential economic benefit on third parties. Such debt collection is fair in light of the fact that the debtor did not live up to his debtor-creditor bargain. But at the same time, courts should not allow creditors to reap profits from all third party recipients. Hence, if a debtor applies his skill to confer a non-economic benefit, creditors should not use such a third party recipient as an outlet to fulfill the debtor's bankruptcy obligations. After all, fraudulent transfer laws are implemented to promote not just honesty in the debtor's dealings with creditors but also to promote honesty among creditors.

Oksana Lashko[†]

[†] J.D. candidate, 2008, Brooklyn Law School; B.A., Colgate University.