



Creditors' Rights

Analyzing the policy provisions, reviewing creditors' rights laws, and identifying creditors' rights issues.

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HOW DOES A CREDITORS' RIGHTS ISSUE ARISE?



- A creditors' rights issue arises when there is a possibility that a prior transfer, usually not our current insured transaction, but rather a previous transaction in the chain, made in either a prior deed, mortgage or lease, may be “undone” or “set-aside”, thus, affecting our current insured transaction, resulting in a possible claim, unless a creditors' rights exception was properly inserted in the policy.
- By the terms “undone” or “set-aside”, we mean a transaction being voided by a court of law or a bankruptcy court of law by either court order or by the broad avoidance power vested in a bankruptcy trustee because the prior transfer was either:
 1. A Fraudulent Transfer, whether by actual or constructive fraud, as defined under the U.S. Bankruptcy Code or under New Jersey law; or
 2. A Preference as defined under the U.S. Bankruptcy Code.

TYPICAL FEATURES ASSOCIATED WITH THE CREATION OF A CREDITORS' RIGHTS ISSUE



1. Because of the structure of the 2021 policies, a creditor's rights issue is usually only an issue associated with a previous or down chain transaction;
2. The Grantor or mortgagor from a previous transaction files a post-transaction petition in bankruptcy or is forced into bankruptcy;
3. A creditor of the grantor or mortgagor of the previous transaction was treated unfairly and/or placed at a disadvantage;
4. Based upon the review by the court or bankruptcy trustee, of the facts surrounding the bankruptcy, it is determined that because of the actions taken by the grantor or mortgagor, prior to filing the bankruptcy petition, placed a creditor or creditors in an unfair or inferior, position;
5. Resulting in the court or bankruptcy trustee, undoing or voiding the prior transaction to effectuate a fair balance of the equities amongst creditors.

ANALYSIS OF THE POLICY PROVISIONS RELATED TO CREDITORS' RIGHTS?

- ❖ To properly analyze a creditors' rights issue, one must apply the policy provisions set-forth in the 2021 policy forms.
 1. Understand the creditors' rights **exclusion.**
 2. Understand the creditors' rights **covered risk.**
 3. Understand the creditors' rights **exception** and know when to use and insert the exception in both the commitment and policy.

- ❖ To accomplish the use and understanding of the exclusion, covered risk and the exception it is important to know:
 1. Creditors' rights laws.
 2. Creditors' rights structure.

POLICY EXCLUSION NO. 6 OF THE 2021 LOAN POLICY (NO. 4 IN THE OWNER'S POLICY):

6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights law, that the **transaction** creating the lien of the Insured Mortgage is a: *the Title as shown in Schedule A is a:
- a. fraudulent conveyance or fraudulent transfer;
 - b. voidable transfer under the Uniform Voidable Transactions Act; or
 - c. preferential transfer:
 - i. to the extent the Insured Mortgage is not a transfer made as a contemporaneous exchange for new value; or
 - ii. for any other reason not stated in Covered Risk 13. (*Covered Risk 9 in the owner's policy.

POLICY COVERED RISK NO. 13 OF THE 2021 LOAN POLICY (NO. 9 IN THE OWNER'S POLICY):

13. The invalidity, unenforceability, lack of priority, or avoidance of the lien of the Insured Mortgage upon the Title, or the effect of a court order providing an alternative remedy:

a. resulting from the avoidance, in whole or in part, of any transfer of all or any part of the Title to the Land or any interest in the Land **occurring prior** to the transaction creating the lien of the Insured Mortgage because that **prior transfer** constituted a:

- i. fraudulent conveyance, fraudulent transfer, or preferential transfer under federal bankruptcy, state insolvency, or similar state or federal creditors' rights law; or
- ii. voidable transfer under the Uniform Voidable Transactions Act;

**POLICY COVERED RISK NO. 13 OF THE 2021 LOAN
POLICY (NO. 9 IN THE OWNER'S POLICY)
CONTINUED:**

b. because the Insured Mortgage (or deed) constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar state or federal creditors' rights law by reason of the failure:

i. to timely record the Insured Mortgage (or deed) in the Public Records after execution and delivery of the Insured Mortgage to the Insured; or notice of its existence to a purchaser for value or to a judgment or lien creditor.

ii. of the recording of the Insured Mortgage in the Public Records to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

THE CREDITORS' RIGHTS EXCEPTION: TO ADD OR NOT TO ADD THAT IS THE QUESTION.



- The creditor's rights exception reads as follows: **Consequences of an attack on the estate or interest insured herein under the Federal Bankruptcy Law or any creditors' rights law or state insolvency law.**

When should the exception be utilized:

- Does the policy exclusion apply? If yes, no need to insert the exception.
- Is a prior transaction in the chain vulnerable to future attack under the bankruptcy code or New Jersey law and subject to possibly being voided?
- Do you recognize a prior transaction in the chain as containing a creditors' rights structure and, if so, do we know what law applies to our situation?
- Note that the exception applies not only to bankruptcy law issues, but also to fraudulent transfers unrelated to the bankruptcy law context.

THE LAW OF CREDITORS' RIGHTS (THE U.S. BANKRUPTCY CODE SECTION 548):



- **Section 548** of the U.S. Bankruptcy Code deals with fraudulent transfers. It permits a bankruptcy trustee to void certain transfers of assets incurred by the debtor prior to filing for bankruptcy.
 - 1 Actual Fraud: Transfers made with the actual intent to hinder, delay or defraud creditors can be voided.
 2. Constructive Fraud: Transfers may be voided if
 - A. The grantor is insolvent at the time of the transfer.
 - B. If the transfer renders the grantor insolvent.
 - C. If the transfer leaves the grantor undercapitalized.
 - D. Insufficient consideration given for the transfer, i.e., the grantor receives less than reasonably equivalent value for the transfer.

THE LAW OF CREDITORS' RIGHTS (THE U.S. BANKRUPTCY CODE SECTION 548) CONTINUED:

3. Two-year look back period applicable to fraudulent conveyances; however, if the trustee relies on the Uniform Fraudulent conveyance Act, under New Jersey law, it may extend the look-back period to 4 years.

Trustee's Remedies: The trustee has 3 remedies available if the test for a Fraudulent Transfer is met:

1. Avoid the transfer.
2. Have the transferee turn over the value of the property to the trustee for the benefit of the BK estate.
3. Have the creditor's interest who benefited from the fraudulent transfer subordinated to the other creditors interest.

THE LAW OF CREDITORS' RIGHTS (THE U.S. BANKRUPTCY CODE Section 547).

- **Section 547** of the U.S. Bankruptcy Code deals with preferential transfers. It allows a bankruptcy trustee to avoid certain transfers made by the debtor before the bankruptcy filing.
 1. Ninety-Day Look-Back period.
 2. 1 year look-back for transfers to insiders.
 3. Requirements for Avoidance:
 - A. Transfer of an interest of the debtor in property.
 - B. The Transfer must be made for benefit of a creditor.
 - C. For or on account of an antecedent debt

THE LAW OF CREDITORS' RIGHTS (THE U.S. BANKRUPTCY CODE Section 547), CONTINUED:

- D. The transfer was made while the debtor was insolvent.
- E. Made on or within 90 days before the filing of the petition, and
- F. One that enables the creditor to receive more than such creditor would receive in a Chapter 7 liquidation of the estate.

Trustees' Remedies The Trustee has two remedies available:

- 1, Avoid the preference (which is often a mortgage), or
2. Subordinate the mortgage or debt to the claims of other creditors, similar to equitable subordination.

IDENTIFYING A CREDITORS' RIGHTS STRUCTURE: FRAUDULENT TRANSFERS AND PREFERENCES:



- When reviewing a prior transaction in the chain of title in the examination process there are questions you should ask when you suspect a possible creditor's rights structure:
 - A. Does it appear that the grantor or mortgagor may have suffered a financial impairment in the transfer?
 1. **Red Flag:** Borrower obtains a mortgage on its property to secure a loan, but the proceeds or benefits of the loan flow to someone else.
 - a. Examples:
 - i. Upstream financing: these types of deals occur when the mortgagor's money does not go to the mortgagor, but rather goes upstream to the

IDENTIFYING A CREDITORS' RIGHTS STRUCTURE: FRAUDULENT TRANSFERS AND PREFERENCES CONTINUED:

owners of the mortgagor, but the mortgagor still owes the money, and the mortgage is secured on its property. This type of transaction includes, leveraged buyouts, guaranty mortgages, and mortgage loans to for the repurchase of stock in a corporation.

- ii. Sidestream financing: This occurs when the proceeds or benefits of a loan flows or goes to an affiliate entity of the mortgagor. This type of transaction includes cross-defaulted or cross-collateralized mortgages.

IDENTIFYING A CREDITORS' RIGHTS STRUCTURE: FRAUDULENT TRANSFERS AND PREFERENCES CONTINUED:

B. Did the grantor or mortgagor receive less than reasonably equivalent value for the transfer?

1. **Red Flag:** Seller sells or transfers property or property is transferred without the Seller or owner getting the full benefit of the sale price or does not receive equivalent value.

a. Examples:

i. Deeds in lieu of foreclosure: What was the value of the property given in lieu of foreclosure.

ii. Judgment execution sales.

iii. Transactions for less than FMV or Bargain price.

IDENTIFYING A CREDITORS' RIGHTS STRUCTURE: FRAUDULENT TRANSFERS AND PREFERENCES CONTINUED:

iv. Collusive or irregular foreclosure sales.

C. Has the statute of limitations expired regarding a possible attack on the transfer as a fraudulent conveyance or preference?

1. **Red Flag:** Expiration of the statute of limitations will remove the threat of a creditors' rights attack on the transfer; but remember the statute of limitations may be longer for someone labeled an insider and a bankruptcy trustee has the power to bring actions to avoid transfers under State law which provide for longer periods for attack rather than to rely upon the bankruptcy code.

THE NEW JERSEY FRAUDULENT TRANSFER ACT (NJFTA) N.J.S.A. 25:2-1 ET SEQ. AND THE UNIFORM TRANSFER ACT (UFTA) N.J.S.A. 25:2-20 ET SEQ.

- There are two general principals that are firmly integrated into these New Jersey Statutes regarding Fraudulent Conveyances:
 1. Did the grantor/debtor attempt to put an asset, in our case his or her real property, out of the reach of creditors? And,
 2. When the grantor/debtor conveyed the property, was there an intent to hinder, delay or defraud creditors?
- If the answer to both questions is yes, then we must consider, in our examination of the chain of title whether the conveyance /transfer that we are reviewing is subject to an attack under the relevant New Jersey statutes and whether the creditors' claim must be dealt with or if we must add a creditors rights exception to our policy.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT:



1. Determine if the creditor who was defrauded, and who seeks to avoid the fraudulent conveyance, is time barred **(N.J.S.A. 25:2-25)**:
 - Did the transfer occur more than 4 years ago or if more than 4 years ago did the creditor take action within one year after discovery of the transfer?
 - Statue of limitations. Must bring timely action to set-aside the transfer.

2. Determine from the facts whether there was clearly no intent to hinder, delay or defraud creditors **(N.J.S.A. 25:2-30a)**:
 - Was the transaction a good faith transaction?
 - Was reasonably equivalent value given for the transfer?

ANALYZING FRAUDULENT CONVEYANCES UNDER NEW JERSEY LAW

3. Determine if the transfer was to an insider or not and was there an antecedent debt owed? **(N.J.S.A. 25:2-27b.)**
 - **Antecedent debt**: A prior debt that the grantor owes and the transfer was made to the insider for a prior debt.
 - **Who are insiders under the UFTA? (N.J.S.A. 25:2-22)**
 - Relative of the transferor
 - A corporation if the transferor/debtor is a director or officer
 - A director or officer if the corporation is the debtor
 - A partnership if the debtor is a general partner
 - Any relative of a general partner, director, officer or person in control.

ANALYZING FRAUDULENT CONVEYANCES UNDER NEW JERSEY LAW

4. Or in the alternative, determine if the transfer was not to an insider and there was no antecedent debt? **(N.J.S.A. 25: 2-27a.)**
 - The courts analysis of whether a transfer of property was a fraudulent transfer under the UFTA, and thus, subject to avoidability is slightly different if the transfer was to an insider:
 - A. The issue of whether the insider knew or should have known that the grantor was **insolvent** is relevant to the insider situation.
 - B. With an insider transfer exemptions may apply. **(N.J.S.A. 25: 2-30f.)**
 - However, under both scenarios the grantor has attempted to hinder, delay or defraud creditors by their transfer and to keep the property away from the reach of creditors even if there is no intent.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT:

- **Transfer by Grantor WAS to an insider WITH an antecedent debt.**
- Question No. 1: Was the grantor or transferor solvent at the time of the Transfer? **(N.J.S.A. 25:2-27b.)**
 - Yes: Go to question No. 3.
 - No: Go to question No. 2.
- Question No. 2: Did the grantee/insider have reasonable cause to believe that the grantor was insolvent, and no exemption applies? **(N.J.S.A. 25:2-27b.)**
 - Yes: **STOP-** Voidable transaction. Creditors' rights issue.
 - No: Go to question No. 3.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT:

- **Transfer by grantor WAS to an insider WITH antecedent debt.**
- Question No. 3: Was reasonably equivalent value given in exchange for the transfer? **(N.J.S.A. 25:2-27a.)**
 - Yes: **STOP-** Not voidable. No creditors' rights issue.
 - No: Go to question No. 4.
- Question No. 4: Was the grantor solvent at the time of transfer, but was rendered insolvent because of the transfer? **(N.J.S.A. 25:2-27b.)**
 - Yes: Go to question No. 6.
 - No: Go to question No. 5.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT

- **Transfer by Grantor WAS to an insider WITH an antecedent debt.**
- Question No. 5: Was the grantor left under-capitalized or with less remaining sufficient assets? **(N.J.S.A. 25:2-25b(1))**
 - Yes: Go to question No. 6.
 - No: **STOP-** Not Voidable. No Creditors' rights issue.
- Question No. 6: The grantee/insider believed or reasonably should have believed that the grantor incurred debts beyond his ability to pay because of the conveyance? **(N.J.S.A. 25:2-25b(2))**
 - Yes: **STOP-** Voidable transaction. Creditors' rights issue.
 - No: **STOP-** Transferee/insider is protected up to value given.
(N.J.S.A. 25:2-30b)

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT:

- Transfer by Grantor that may be considered a voidable transfer:
- Question No. 1: Was reasonably equivalent value given in exchange for the transfer? **(N.J.S.A. 25:2-27a.)**
 - Yes: STOP-Not Voidable. No creditors' rights issue.
 - No: Go to question No. 2.
- Question No. 2: Was the grantor or transferor solvent at the time of the Transfer? **(N.J.S.A. 25:2-27a.)**
 - Yes: Go to question No. 3.
 - No: Go to question No. 5.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT

- Transfer by Grantor that may be considered a voidable transfer:
- Question No. 3: Was grantor solvent at time of transfer, but rendered insolvent because of the transfer? **(N.J.S.A. 25:2-27a.)**
 - Yes: Go to question No. 5.
 - No: Go to question No. 4.
- Question No. 4: Was the grantor left under-capitalized or with less remaining sufficient assets? **(N.J.S.A. 25:2-25b(1))**
 - Yes: Go to question No. 5.
 - No: **STOP-** Not voidable. No Creditors' rights issue.

ANALYZING FRAUDULENT CONVEYANCES UNDER THE UNIFORM FRAUDULENT TRANSFER ACT:

- Transfer by Grantor that may be considered a voidable transfer:
- Question No. 5: The grantee or transferee believed or reasonably should have believed that the grantor incurred debts beyond his ability to pay because of the conveyance? **N.J.S.A. 25:2-25b(2).**
 - Yes: STOP- Voidable transaction. creditors' rights issue.
 - No: STOP- Transferee is protected up to value given.
N.J.S.A. 25:2-30b.

SUMMARY OF ISSUES UNDER THE UFTA:

- Regardless of whether the transfer came after the debt to the creditor was incurred or before the debt was incurred or whether it was to an insider for an antecedent debt or not, the important considerations are:
- Was reasonably equivalent value given in exchange for the transfer?
- Was the grantor or solvent at the time of the Transfer?
- Was grantor solvent at time of transfer, but rendered insolvent because of the transfer?
- Was the grantor left under-capitalized or with less remaining sufficient assets?
- Did the grantee/insider know or should have known that the transaction was voidable based upon economic condition of the grantor after the transfer.

THE ALTA 21 VERSUS THE CREDITORS' RIGHTS EXCLUSION POST ALTA 21 DE-CERTIFICATION:



- Prior to 2010, the ALTA 21 endorsement was available in New Jersey for creditor rights coverage and was in high demand by lenders.
- It provided affirmative coverage for the possible loss or damage suffered in the “insured transaction” for avoidance by a trustee or court of the insured transaction as a fraudulent conveyance or as a preference.
- In 2010 the ALTA 21 was de-certified by ALTA and most major underwriters, including STGC, decided on a national basis to discontinue to offer creditor’s rights coverage.
- As a result of the de-certification of the ALTA 21 any request for removal of the exclusion or for any affirmative coverage regarding creditor’s rights must be unequivocally denied.

DEBTOR'S POSSESSION; REVIVAL OF LIENS:

- **Revival of liens doctrine:** When a debtor loses their property through a judicial proceeding, such as a foreclosure sale or a judgment execution sale, the liens against the debtor that attached to the property prior to the foreclosure sale or judgment execution sale reattach to the property or revived when the debtor takes back title.
- Purchase money mortgage obtained by the debtor who is reacquiring the property will be superior to the liens and the lender may accept a loan policy with a Schedule B, Part II.
- As for the owner's policy, the "acts of the insured" exclusion may protect the insured from liability from the attack from a prior lien holder.
- Under these circumstances, it is usually prudent to insert a creditors' rights exception.



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