

Shocker! Fraudulent Transfer Leads to Judgment Against Transferee

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The 16th Century gave plenty to the world – Leonardo da Vinci's 'Mona Lisa,' the Scientific Revolution, the Protestant Reformation, Michaelangelo's 'David,' and the Statute of Elizabeth.

That last one may be a head-scratcher, but it's the most relevant historical contribution in that list for lenders and special assets departments (at least for doing your job). The Statute of Elizabeth abolished transfers of property done to delay, hinder, and defraud creditors. North Carolina, like most states, has a modern statute – the Uniform Voidable Transactions Act – that codifies this 450-year-old prohibition on disposing of assets to evade your creditors and makes such transfers voidable.

You would think that, after all that time, debtors would pause before engaging in a blatant voidable transfer. And you would be wrong. A recent decision from the North Carolina Court of Appeals illustrates a creditor's burden of proof and remedies when they are the victim of a voidable transfer.

Omi was a company in the vinyl tile flooring business. It sold flooring to Surface Source. Richard Yu was Surface Source's President, CEO, Director, and Registered Agent and owned 10% of the company stock. In 2017, Surface Source failed to pay over \$1,000,000 owed to Omi, and Omi sued them.

A different creditor had already foreclosed on all of Surface Source's personal property assets – they "even took the mop away," according to one witness. After that, Surface Source was left with one valuable asset: It owned a warehouse in Lexington, North Carolina. When Surface Source began to struggle financially, Yu formed a new company – Opel – to do the same business, only untethered by Surface Source's liabilities. Yu owned 60% of the Opel stock. Opel operated out of the Lexington warehouse.

You know what happened next. As Omi neared judgment, Surface Source transferred the Lexington warehouse to Opel. Then, it switched lawyers and was a no-show at trial. Needless to say, Omi won. But, because of the transfer, Omi could not attach a judgment lien against the Lexington warehouse.

Therefore, Omi sued Opel on two alternative theories: (1) Opel was Surface Source by another name and liable under the doctrine of successor liability, or (2) the transfer of the Lexington warehouse was a fraudulent transfer under the Uniform Voidable Transactions Act. As the transferee, Opel argued that it could avail itself of the "good-faith exception" to a voidable transfer. But to establish that defense, Opel had to prove that it took the property in good faith and for a reasonably equivalent value.

We have various legal definitions and tests of good faith, but think of it this way: A good faith transferee is someone who is "shocked, shocked" to find out the background of the transfer, and the reaction is legitimate and supported by the facts. Contrast that with Captain Renault, who is "shocked, shocked" to find out that gambling is going on in Rick's Café, then collects his winnings from the croupier. Not good faith. Opel failed the "Casablanca" test, and the trial court ruled for Omi on both claims. Now Omi had a \$1.1 million judgment against Opel and could execute against the Lexington warehouse.

This case did not appear to be a close call. When it could not pay its debts and was in active litigation with Omi, Surface Source transferred its only asset to Opel. Opel was not a *bona fide* third-party purchaser for reasonably equivalent value. It was a company formed and owned by Surface Source's president and CEO, whose knowledge of Surface Source's fraudulent intentions. The case is good news for creditors, but one can't help but read it with some frustration. On facts that look like a slam-dunk fraudulent transfer, Omi has litigated for over seven years. As far as the author can tell, Omi's \$1.1 million judgments remain unpaid.

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