Bankruptcy Court Tightens Intentional Fraudulent Transfer Pleading Requirements

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On November 18, 2015, the U.S. Bankruptcy Court for the Southern District of New York dismissed intentional fraudulent transfer claims asserted by a bankruptcy litigation trustee against former shareholders of Lyondell Chemical Company in *Weisfelner v. Fund 1* (*In re Lyondell Chemical Co.*) (*Lyondell II*). By adopting a strict view of what constitutes intent, the opinion tightens pleading standards applicable to these cases. It bears watching whether other courts will apply *Lyondell II*'s more demanding pleading standards.

Background

In December 2007, Lyondell Chemical Company was acquired by Basell AFSCA in a leveraged buyout (LBO). As is typical in such transactions, Lyondell itself borrowed money to finance the LBO, and approximately $12.5 billion of borrowed funds were transferred to Lyondell's pre-LBO shareholders to acquire their Lyondell shares.

Just 13 months after the LBO, Lyondell filed a voluntary Chapter 11 petition. Under the company's bankruptcy plan, litigation trusts were formed to pursue causes of action on behalf of Lyondell and its creditors. Eventually, the trustee asserted fraudulent transfer actions seeking to recover $12.5 billion from Lyondell's former shareholders.

Bankruptcy Court Decisions

The bankruptcy court dismissed the trustee's intentional fraudulent transfer allegations in his initial complaint (*Lyondell I*) but granted leave to replead. After the trustee filed amended intentional fraudulent transfer allegations, the shareholder defendants moved to dismiss them, and the court agreed in *Lyondell II* that the new allegations failed to state intentional fraudulent transfer claims. Specifically, the bankruptcy court said that the plaintiff must plead facts that show actual intent, as opposed to implied or presumed intent.

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Moreover, a plaintiff cannot sustain an intentional fraudulent transfer claim based on a careless, imprudent or aggressive business strategy that has the effect of impeding creditor recoveries. Rather, a plaintiff must show that the actor's primary motivation is to move assets beyond a creditor's reach. A plaintiff must allege some sort of "intentional action to injure creditors." Alleging "[o]ther wrongful acts that … may be seriously prejudicial to creditors" — such as negligence or a breach of fiduciary duty — will not support an intentional fraudulent transfer claim.

The *Lyondell II* court adopted the Restatement (Second) of Torts standard in which intent exists when "the actor *desires* to cause consequences of his act, or that he believes that the consequences are *substantially certain to result* from it" (emphasis in original). The court rejected the more lenient "natural consequences" standard set forth by the U.S. Court of Appeals for the Seventh Circuit in *In re Sentinel Mgmt. Grp*.

As for what allegations are necessary to prove intent, the court considered traditional "badges of fraud," "motive and opportunity" and "recklessness" allegations. The court concluded that traditional badges of fraud allegations (*e.g.*, a concealed transfer, a transfer to an insider, a transfer where the transferor retains possession or control of the transferred property, or a transfer of substantially all the debtors' assets) are indicative of the kind of specific intent required by the restatement.

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The court recognized that "motive and opportunity" allegations, if proven, might show a defendant's motive and opportunity to commit fraud or provide strong circumstantial evidence of conscious misbehavior or recklessness. However, the court also acknowledged that apparent "motive and opportunity" might be pleaded in benign situations and, therefore, such allegations are not a strong indicator of the intent needed to support an intentional fraudulent transfer claim. The court said that in order to plead restatement-level specific intent with motive and opportunity allegations, a plaintiff also must allege additional facts indicative of intent. Moreover, an inference of fraudulent intent discerned through "motive and opportunity" allegations must outweigh opposing inferences that could be drawn from the same allegations. The court emphasized the distinction between motive to injure creditors (which could indicate the requisite intent) and mere "motive for self-enrichment" or attempt to maximize shareholder value (which is insufficient to support an intentional fraudulent transfer claim).

As for allegations tantamount to "recklessness," the court ruled such allegations may survive a motion to dismiss only if a plaintiff also alleges facts showing a state of mind approximating actual intent. Lesser allegations, such as allegations of negligence, cannot support an intentional fraudulent transfer claim.

The *Lyondell II* court held that the trustee's amended allegations did not satisfy the heightened restatement standard of intent. While the trustee's amended complaint alleged that Lyondell's board of directors did not exercise proper care in pursuing the LBO, and that one director had intent to defraud other parties to the LBO, dismissal with prejudice was required because the trustee failed to allege facts supporting the conclusion that the board of directors "*intended* that any creditor be hindered, delayed or defrauded" (emphasis in original).