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Feature

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Nondebtor Transfers Fall Outside the Scope of the Delaware UFTA



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Avoidance actions based on actual fraud are rare and frequently unsuccessful, especially in bankruptcy court. To prevail, a movant faces the herculean task of establishing actual intent to hinder, delay or defraud creditors under 11 U.S.C. § 548(a)(1)(A) and/or applicable state avoidance statutes because they usually provide a longer clawback period than the Bankruptcy Code.¹ Yet, even when actual intent to hinder, delay or defraud is readily apparent, such actions might prove futile due to a modern Byzantine corporate ownership structure and its legal protections. Despite recognizing actual intent to hinder collection efforts behind a series of transfers, the Third Circuit recently felt compelled to reverse an order ruling in favor of an aggrieved creditor on a fraudulent-transfer claim under the Delaware Uniform Fraudulent Transfer Act (DUFTA)² because the transfer had not been made by a debtor.³

Factual Background

On the eve of the 2008 financial crisis, in June 2007, Crystallex International Corp., an entity specializing in the gold mining and exploration industry, announced that it would begin mining operations at the Las Cristinas site located in the Bolivarian Republic of Venezuela.⁴ Thereafter, gripped by the crisis with no easy or fast solution, Venezuelan governmental officials desperately sought revenue sources⁵ while Crystallex continued to make substantial capital contributions into the

project.⁶ Unfortunately, Crystallex had been denied a key environmental permit, and the Las Cristinas gold deposits were seized and nationalized in early 2009.⁷ Consequently, Crystallex was forced into bankruptcy, and complex legal disputes followed.⁸

Litigation Background

After years of arbitration, Crystallex won an award of \$1.2 billion against Venezuela.⁹ However, Venezuelan officials announced publicly, on numerous occasions, that Venezuela would refuse to pay and even thwart the arbitration award enforcement.¹⁰ To that end, it managed to monetize and remove its interest in Citgo Petroleum Corp., its largest American asset, out of the U.S., effectively shielding the funds from Crystallex's reach.¹¹ The scheme consisted of a series of debt offerings and upstream dividends among closely related U.S. entities, leading to a transfer of \$2.8 billion to a Venezuelan wholly owned state oil producer, Petróleos de Venezuela SA (PDVSA).¹²

Meanwhile, Crystallex initiated a slew of collection efforts targeting the U.S. assets of PDVSA.¹³ Crystallex filed a complaint in the U.S. District Court for the District of Delaware¹⁴ that asserted

1 See, e.g., Georgia Uniform Fraudulent Transfer Act O.C.G.A. § 18-2-79; Florida Uniform Fraudulent Transfer Act § 726.110(1).

2 6 Del. C. § 1301, *et seq.*

3 *Crystallex Int'l Corp. v. Petróleos De Venezuela SA*, 879 F.3d 79, 89-90 (3d Cir. 2018) (hereinafter "*Crystallex I*"). However, this article does not address any other issues raised by the parties or discussed by tribunals in this litigation.

4 *Crystallex Int'l Corp. v. Bolivarian Republic of Venezuela*, 244 F. Supp. 3d 100, 106 (D.D.C. 2017).

5 Juan Ferero, "Oil-Rich Venezuela Gripped by Economic Crisis," *Washington Post Foreign Service* (April 29, 2010), available at [washingtonpost.com/wp-dyn/content/article/2010/04/28/AR2010042805712.html](http://www.washingtonpost.com/wp-dyn/content/article/2010/04/28/AR2010042805712.html) (unless otherwise specified, all links in this article were last visited on March 29, 2018).

6 Nikolas S. Komyati and Jordan J. Levine, "Looking to Defraud Creditors? Talk to Your Foreign Subsidiary!," *New Jersey Law Journal* (Feb. 10, 2018), available at [bressler.com/looking-to-defraud-creditors-talk-to-your-foreign-subsidiary](http://www.bressler.com/looking-to-defraud-creditors-talk-to-your-foreign-subsidiary).

7 *Crystallex Int'l Corp. v. Bolivarian Republic of Venezuela*, 244 F. Supp. 3d 100, 106 (D.D.C. 2017) ("In early 2009, then-Venezuelan President Hugo Chávez announced this year [that] the Venezuelan State has taken over the exploitation and control of the gold deposits of Las Cristinas.") (internal quotations omitted).

8 Komyati and Levine, *supra* n.6, at 1.

9 *Crystallex II*, 879 F.3d at 90.

10 *Id.* at 82.

11 *Id.*

12 *Id.*

13 *Id.*

14 *Crystallex Int'l Corp. v. Petróleos de Venezuela SA*, 213 F. Supp. 3d 683 (D.D.C. 2016) (hereinafter, "*Crystallex I*"), reversed by *Crystallex II*.

claims based on the (1) fraudulent-transfer theory under DUFTA and (2) common law civil conspiracy against PDVSA and its wholly owned subsidiary, PDV Holding Inc. (PDVH), as well as CITGO Holding Inc., both Delaware corporations (collectively, the “defendants”).¹⁵

The Corporate Ownership Structure

Venezuela owns 100 percent of PDVSA’s shares.¹⁶ It is Venezuela’s instrumentality that provides substantial funding resources and serves as a medium to effectuate government policies.¹⁷ PDVSA owns 100 percent of PDVH, which (through its subsidiaries) owns and operates oil refineries and oil and gas pipelines in the U.S.¹⁸ One of PDVH’s wholly owned subsidiaries is Citgo Holding Inc., which operates in the U.S. and refines, markets and transports petroleum products.¹⁹ Lastly, Citgo Holding Inc. owns 100 percent of Citgo Petroleum Corp., another Delaware corporation, which refines, transports and markets transportation fuels, lubricants, petrochemicals and other industrial products.²⁰

Pursuant to the complaint, as part of its plan to thwart enforcement of the arbitration award, Venezuela (through its alter-ego, PDVSA) directed PDVSA’s wholly owned subsidiary PDVH to then direct its wholly owned subsidiary Citgo Holding Inc. to issue \$2.8 billion in debt.²¹ The debt offering left Citgo Petroleum Corp., Venezuela’s largest American asset, virtually insolvent, with most of its value transferred to Citgo Holding Inc.²² Thereafter, instead of investing the proceeds from the debt issuance, Citgo Holding Inc. transferred the funds, which had been disguised as a shareholder dividend, to its parent, PDVH.²³ Similarly, PDVH declared a dividend of the same amount to its parent, PDVSA, resulting in officially repatriating the money to Venezuela, thereby rendering them virtually inaccessible to Crystallex.²⁴

The defendants fought back by filing a motion to dismiss the claims for failure to state a claim.²⁵ The district court dismissed all claims against PDVSA and Citgo Holding Inc., as well as a civil conspiracy claim against PDVH.²⁶ However, it allowed Crystallex to proceed against PDVH on its sole remaining DUFTA fraudulent-transfer claim.²⁷

In pertinent part, DUFTA allows a party to avoid a transfer if “[a] transfer made ... by a debtor is fraudulent as to a creditor.”²⁸ The transfer is fraudulent if the debtor “made the transfer or incurred the obligation with actual intent to hinder any creditor of the debtor.”²⁹ Therefore, a transfer will be avoided if a movant establishes three elements: (1) a transfer (2) made by a debtor (3) with intent to hinder, delay or defraud.

The district court found that the allegations in the complaint sufficiently stated that a transfer was made.³⁰ As the district court took Crystallex’s allegations that Venezuela’s officials boldly announced intent to forestall any arbitration award enforcement efforts on its face, the litigation hinged on whether the transfer made by a subsidiary of the debtor satisfied the “by a debtor” element.³¹ In the absence of any guidance from the Supreme Court of Delaware, the district court had to predict how that tribunal would rule on this narrow issue.³²

The district court immediately recognized that in the narrowest sense of the term, none of the transfers were alleged to have been directly undertaken by a debtor, to wit, Venezuela or PDVSA.³³ Yet, in deciding the motion to dismiss, the district court reasoned that the series of transfers were arranged and directly requested by Venezuela and/or its instrumentality, PDVSA.³⁴ Therefore, as Venezuela and PDVSA were the proverbial men behind the curtain within the scheme, the district court reasoned that such transfers must be made in every meaningful sense “by a debtor,” thereby satisfying DUFTA’s requirements for a fraudulent transfer.³⁵ The district court was confident that its holding was conforming to principles of law and equity applicable under DUFTA.³⁶

Subsequently, upon PDVH’s motion, the district court certified the following question to the Third Circuit: Does DUFTA contemplate its applicability to “nondebtor transferors” acting on the debtor’s behalf, absent allegations of alter-ego or piercing the corporate veil?³⁷ Rejecting the equity considerations or any reliance on any dictionary definitions, the Third Circuit answered this question in the negative.³⁸

At the outset, the Third Circuit pointed out that the transfer that Crystallex was seeking to avoid was made by PDVH to PDVSA; thus, it was not made by a debtor, but rather to a debtor.³⁹ Therefore, the Third Circuit found that under DUFTA, Crystallex’s

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15 *Id.* at 686-87.

16 *Crystallex II*, 879 F.3d at 82.

17 “History,” *Petróleos De Venezuela*, available at www.pdvsa.com/index.php?option=com_content&view=article&id=6541&Itemid=888&lang=en.

18 *Crystallex II*, 879 F.3d at 82; see also “Company Overview of PDV Holding Inc.,” Bloomberg, available at bloomberg.com/research/stocks/private/snapshot.asp?privcapid=27976105.

19 *Crystallex II*, 879 F.3d at 82; see also “Citgo Holding Inc.: Company Profile,” Bloomberg, available at bloomberg.com/profiles/companies/53682:US-citgo-holding-inc.

20 *Crystallex II*, 879 F.3d at 82; see also “Company Overview of CITGO Petroleum Corp.,” Bloomberg, available at bloomberg.com/research/stocks/private/snapshot.asp?privcapid=864763.

21 *Crystallex II*, 879 F.3d at 82.

22 *Id.* at 82 n.4.

23 *Id.* at 82.

24 *Id.*

25 *Crystallex I*, 213 F. Supp. 3d at 686.

26 *Id.* at 697.

27 *Id.*

28 *Id.*

29 6 Del. C. § 1304(a)(1); DUFTA permits a creditor to obtain an “[a]voidance of the transfer ... to the extent [that is] necessary to satisfy the creditor’s claim.” 6 Del. C. § 1307(a)(1).

30 *Crystallex I*, 213 F. Supp. 3d at 692.

31 *Id.* at 691-92.

32 *Id.* at 689.

33 *Crystallex I*, 213 F. Supp. 3d at 691-92.

34 *Id.* at 691.

35 *Id.* at 692.

36 *Id.*

37 *Crystallex Int’l Corp. v. Petróleos De Venezuela SA*, Case No. 15-1082-LPS, 2016 WL 7440471, at *3 (D.D.C. Dec. 27, 2016).

38 *Crystallex II*, 879 F.3d at 83-90.

39 *Id.* at 84.

only potential targets could be either Venezuela or its alter-ego, PDVSA.⁴⁰ The Third Circuit bluntly stated that the absence of allegations asserting PDVH's alter-ego status of either Venezuela or PDVSA, or any other basis to pierce the corporate veil, was fatal.⁴¹

Crystallex essentially failed to allege that PDVH was a debtor or would otherwise be liable for the arbitration award.⁴² In light of the foregoing, in the Third Circuit's view the transaction at issue lacked the principal tenet of fraudulent-transfer statutes: an alienation of assets, otherwise available to creditors, in order to obstruct collection efforts.⁴³ Instead, the Third Circuit simply called it a geographical alienation, shielding the assets from the creditors' reach by virtue of international law.⁴⁴ According to the Third Circuit, DUFTA does not cover such a set of circumstances.⁴⁵

The Third Circuit assessed and analyzed Delaware lower court decisions addressing both DUFTA and Bankruptcy Code's analogous provisions, as well as other Delaware state law principles.⁴⁶ In giving them due deference, the Third Circuit observed that these authorities had not allowed fraudulent-transfer causes of actions against nondebtor transferors, such as the one at issue, under either DUFTA or the Bankruptcy Code. The Third Circuit stated that its ruling will preserve a fundamental precept of Delaware corporate law: the separate legal existence of a parent and subsidiary.⁴⁷ The separate legal existence of corporations is not and should not be disregarded lightly.⁴⁸

Other arguments raised by Crystallex also were unavailing. Specifically, the Third Circuit rejected Crystallex's interpretation of another provision of DUFTA, § 1308 (purportedly imposing liability upon nondebtor transferors), as illogical.⁴⁹ Crystallex suggested that DUFTA should be expanded to impose liability on bad-faith nondebtor transferors because good-faith transferees are immune from liability under the statute.⁵⁰ The Third Circuit found such an expansion of DUFTA to be impermissible.⁵¹ Crystallex continued its attempts to persuade the Third Circuit to affirm by relying on a limited number of non-binding opinions from other jurisdictions, which purportedly supported its cause.⁵² These authorities were rejected as inapposite and distinguishable.⁵³

Lastly, the Third Circuit did not completely reject the notion that DUFTA would not cover "an indirect transfer" by a debtor.⁵⁴ However, as previously mentioned, the complaint asserted that the debtor at issue was the recipient of the assets.⁵⁵ Consequently, as the complaint failed to allege PDVH's alter-ego status or sought to invoke the piercing-of-the-corporate-veil doctrine, the complaint failed to assert

that there had been any transfer made by a debtor.⁵⁶ Based on the foregoing, the Third Circuit concluded that it could not affirm the district court's ruling denying the motion seeking dismissal for failure to state a claim for fraudulent transfer under DUFTA.⁵⁷

Conclusion

If the Third Circuit had ruled in Crystallex's favor, without reliance on the piercing-the-corporate-veil doctrine, it would have expanded DUFTA's scope and potentially other fraudulent-transfer state statutes, as well as the fraudulent-transfer law under the Bankruptcy Code, in unanticipated ways.⁵⁸ Such a ruling could, for instance, have a chilling effect on certain types of transfers by financial institutions in possession of the foreign-owned assets due to a fear of incurring potentially massive liability under state fraudulent-transfer statutes. Ultimately, while there are substantial grounds for difference of opinion with Crystallex's novel fraudulent-transfer theory, the outcome can be simply summarized. In order to have a fraudulent-transfer claim, one must first have a valid claim against a person. Otherwise, piercing the corporate veil is necessary.

The Crystallex saga is not over yet. Specifically, the parties filed a joint status report in the underlying district court case indicating that Crystallex is now working on proposed amendments that would satisfy the Third Circuit's standard and intends to seek leave to amend the complaint.⁵⁹ However, the defendants will fiercely oppose it.⁶⁰ As such, stay tuned for further developments. **abi**

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40 *Id.* at 84-85.

41 *Id.*

42 *Id.* at 85.

43 *Id.* at 84.

44 *Id.* at 85.

45 *Id.*

46 *Id.* at 85-86. The Third Circuit found Delaware lower court opinions that address § 548(a)(1)(A) to be instructive, as relevant DUFTA provisions nearly mirror the Bankruptcy Code's provisions. *Id.*

47 *Id.* at 86.

48 *Id.*

49 *Id.* at 87.

50 *Id.*

51 *Id.*

52 *Id.* at 87-88.

53 *Id.* at 87.

54 *Id.* at 89.

55 *Id.*

56 *Id.*

57 *Id.* at 88-89.

58 Tellingly, DUFTA is "virtually a carbon copy of the Bankruptcy Code's fraudulent transfer laws." *Id.* at 86.

59 *Crystallex I*, Case No. 1:15-cv-01082-LPS, D.E. 108, at 2 (D.D.C. Feb. 20, 2018).

60 *Id.*