

# Follow the Money: Increasing the Chances of Recovery

BY JACOB MARSHALL

In the midst of the worst economic downturn since the Great Depression, it is more important than ever that attorneys filing suit determine quickly whether an entity defendant is being made "judgment proof." It is also prudent for attorneys to take extra care in joining all culpable parties.

While there is no "one size fits all" approach for addressing these problems, this article provides some theories and strategies for following the money to culpable, solvent recovery sources.

First, gathering information and evidence quickly is critical. Lawyers and clients should put on their sleuth hats early and start talking to all available sources about the defendant's business, corporate structure, assets and asset transfers. Also, take advantage of

online resources for locating people, assets and financial relationships through public documents. Further, counsel might consider filing a Tex. R. Civ. P. 202 pre-lawsuit deposition action to investigate potential fraudulent transfer claims.

The Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code §24.001, et seq., provides tools for "following the money" where a company makes transfers with the actual intent to hinder, delay or defraud any creditor or under circumstances that amount to constructive fraud, such as when transfers are made without reasonably equivalent value.

Intent to defraud can be shown by establishing one or more "badges of fraud," including whether the transfer went to an insider, was concealed, followed a money demand

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or the filing of a lawsuit, or included substantially all of the debtor's assets. Alternatively, if the debtor made the transfer without receiving reasonably equivalent value at a time when the debtor was insolvent, or in the "zone of insolvency," a current creditor need not show actual fraudulent intent. One issue to watch is whether the recent decision by the Finance Accounting Standards Board granting companies more flexibility in valuing assets will hamper a creditor's ability to establish insolvency.

The UFTA allows a creditor to seek, among other things, a pre-judgment attachment of the asset transferred, avoidance of the transfer, an injunc-

tion preventing further transfers by the debtor or a transferee, and the appointment of a receiver. The pre-judgment remedies must be sought under the exacting requirements of the Texas Rules of Civil Procedure and Civil Practice & Remedies Code, including the filing of an appropriate bond and supporting evidence. As an alternative to voiding a transfer, the creditor may recover a judgment against the first transferee of the asset or any subsequent transferee, other than one who took in good faith for value.

If you fear your defendant is undercapitalized, explore whether a parent or affiliated company might also justly be held liable. The Texas Supreme Court's recent decision in *SSP Partners v. Gladstrong Investments (USA) Corp.*,

275 S.W.3d 444, 456 (Tex. 2008) did away with the single business enterprise theory for extending liability to affiliated companies. The Court nevertheless left intact the joint enterprise theory, the elements of which are an agreement among the entities, a common purpose, a community of pecuniary interest, and an equal right of control. *Id.* at 451.

Common law "piercing the corporate veil" and "alter ego" theories remain viable where "the corporate form has been used as part of a basically unfair device to achieve an inequitable result." *Castleberry v. Branscum*, 721 S.W.2d 270, 271 (Tex. 1986). The legislature, however, added the requirement that a plaintiff show that the shareholder used the "entity shield" to perpetrate an actual fraud on the plaintiff for the benefit of the shareholder. Tex. Bus. Corp. Act Art. 2.21; Tex. Bus. Org. Code Art. 21.223.

Finally, in recent news reports, a claim for conspiracy to breach fiduciary duties recently resulted in a \$178.7 million verdict for minority sharehold-

ers claiming that the majority shareholder and other related parties took improper actions to minimize the valuation of their shares in a share repurchase. This theory allowed the minority shareholders, at least at the trial court level, to extend liability beyond the contractual parties. While the defendants' counsel argues the verdict is legally flawed, conspiracy to violate fiduciary duties can be a viable claim in the right circumstances. Similarly, because corporate agents generally are liable for their own fraudulent and tortious acts, even when committed while in the service of their corporation, attorneys should consider adding these parties as well.

By exploring and prosecuting fraudulent transfers and pursuing every viable claim and party, attorneys can help maximize their client's chances of a real recovery. **HN**

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