RIGHTS OF INDEMNIFICATION AND CONTRIBUTION AMONG PERSONS LIABLE FOR FRAUDULENT CONVEYANCES

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One little explored issue in the many reported cases involving fraudulent conveyances in leveraged buyouts is whether a party defendant in a fraudulent conveyance action may seek indemnification or contribution from other parties to the transaction for the defendant's ultimate liability in the action.

In the classic leveraged buyout (LBO), a shell corporation (the Acquirer) owned by the new investors acquires the stock of the target corporation (the Target) using funds borrowed from a bank or other lender. Because the Acquirer has no assets of its own, it causes the Target, simultaneously with the acquisition by the Acquirer of the Target's stock, to guaranty repayment of the Acquirer's loan and give the lender a security interest in the Target's assets to secure the Target's obligation under the guaranty.[1] The borrowed money, repayment of which the Target has guaranteed, does not benefit the Target.[2] Rather, it is paid by the Acquirer to the Target's former shareholders, thus setting up the potential fraudulent conveyance. If the Target does not receive a reasonably equivalent value in exchange for the obligation incurred under the guarantee and the transfer made by virtue of the grant of the security interest, and is rendered insolvent or left with unreasonably small capital as a result, a trustee in bankruptcy[3] may seek to avoid the guaranty and the security

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1 The transaction may also take the form of a merger by the Acquirer into the Target, thereby causing the Target to assume the liability for the loan by operation of law, or a loan directly to the Target, which uses the proceeds to redeem the stock of the selling shareholders. The cases that collapse the steps in an LBO recognize that these alternative structures are functionally equivalent.

2 An advance may also be made to the Target for working capital purposes and, to that extent, the Target may receive reasonably equivalent value.

3 Unless the court orders otherwise, a debtor in possession in a chapter 11 case

interest under federal law pursuant to 11 U.S.C. § 548(a) or under a comparable state law fraudulent conveyance statute pursuant to 11 U.S.C. § 544(b).[4]

Under 11 U.S.C. § 550, the trustee may recover property, or the value thereof, transferred in connection with the fraudulent conveyance from the initial transferee of such transfer or any immediate or mediate transferee of the initial transferee.[5] In an LBO scenario, the property transferred is typically the consideration paid to the selling shareholders. As a result, the trustee may seek to recover from the lender who received the security interest, from the selling shareholders[6] who received the proceeds of sale or from both, although the trustee is only entitled to a single satisfaction.[7]

Although a diligent trustee may seek to recover the property transferred pursuant to a fraudulent conveyance from all of the parties involved in the LBO as a means of maximizing his chances for recovery, there are a number of reasons why a trustee may not seek to do so.[8] When the trustee seeks to recover from only some of the parties to the LBO, rights of indemnification

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has the same avoidance powers as a trustee. Bankruptcy Code § 1107(a), 11 U.S.C. § 1107(a) (1992).

4 Those state law statutes include the Uniform Fraudulent Conveyance Act (UFCA), originally promulgated by the National Conference of Commissioners on Uniform State Laws in 1918 and presently in force in eight states and the Virgin Islands, and the Uniform Fraudulent Transfer Act (UFTA), promulgated by the Commissioners in 1984 to update the UFCA and presently in force in 30 states. *See* 7A Uniform Laws Annotated (Master ed. Supp. 1993).

5 11 U.S.C. § 550(a)(1), (2).

6 At least in the Tenth Circuit, the selling shareholders have a defense under Bankruptcy Code § 546(e), which prevents a trustee (or debtor in possession) from avoiding "a transfer that is a . . . settlement payment, as defined in section 741(8) of this title" absent a showing of actual fraudulent intent. 11 U.S.C. § 546(e) (1992). *See In re* Kaiser Steel Corp., 952 F.2d 1230, 1237 (10th Cir. 1991), *cert. denied,* 112 S. Ct. 3015 (1992) (payments to selling shareholders qualified as a settlement payment, when the payments were made through stockbrokers, financial institutions or securities clearing agencies); Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 846, 848-49 (10th Cir. 1990) (same); Wieboldt Stores v. Schottenstein, 131 B.R. 655, 663-65 (N.D. Ill. 1991) (contra).

7 11 U.S.C. § 550(c).

8 These reasons include inability to locate or exercise jurisdiction over a transferee, a cost-benefit analysis of pursuing small transferees, and insolvency of one or more of the transferees. For instance, in the *Kaiser Steel* case, the trustee initially sought to pursue the claim against the brokers who held the stock as nominees for their customers to avoid the costs of asserting claims directly against each beneficial owner of the stock. *Kaiser Steel,* 913 F.2d at 846. In addition, absent access to the brokers' records, the trustee is unlikely to have been able to identify the individual customers because the debtor's records would only reflect the brokers as the registered owners of the stock.

and contribution, if they exist, can be of significant value to the named defendants.

Assuming that no contractual right of indemnification or contribution exists between the parties to the LBO, this Article considers whether rights of indemnification and contribution exist as a matter of law in favor of parties to such a transaction who are found liable for a fraudulent conveyance. First, the article considers whether such rights exist as a matter of federal law, either under the Bankruptcy Code or federal common law. Thereafter, this Article considers whether such rights exist under the laws of the State of New York, which is not only a center of commercial activity in the United States, but which has also adopted the Uniform Fraudulent Conveyance Act (UFCA) and the Uniform Contribution Among Tortfeasors Act. Consequently, consideration of the question under New York law will likely be relevant in other states that have also adopted these uniform laws.

I. Indemnification and Contribution Under Federal Law

A. *Indemnification Under the Bankruptcy Code*

Because the Bankruptcy Code does not provide an express cause of action for indemnification in a fraudulent conveyance action, any such cause of action arising under the Code would have to be implied. The courts, however, have refused the invitation to do so.[9] For example, in *In re John Peterson Motors, Inc.*,[10] the defendant in a preference action, Borreson, brought a third party action against Peterson seeking indemnity or contribution for any sums recovered against Borreson in the preference action. In considering Peterson's motion to dismiss, the court presumed that the third party action was based on state law because there was no basis under federal law on which the claim could be brought. As the court explained:

> Presumably Borreson's claim for indemnity or contribution is based on state law. There is no federal general common law, . . . and "[a]bsent some Congressional authorization to formulate substantive rules of decision, federal common law exists

9 *See generally* Weiboldt Stores, Inc. v. Schottenstein, 111 B.R. 162, 167-68 (N.D. Ill. 1990); Airport Center Associates, L.P. v. Integrated Resources Inc., (*In re* Integrated Resources, Inc., 90 B. 10411, Adv. No. 91-5114A (Bankr. S.D.N.Y. Sept. 4, 1991)) (unpublished decision read into the record by Judge Blackshear); *In re* John Peterson Motors, Inc., 56 B.R. 588, 591 n.5 (Bankr. D. Minn. 1986).

10 56 B.R. 588 (Bankr. D. Minn. 1986).

> only in [narrow areas]." There is certainly nothing in Title 11 to suggest that Congress expressly or implicitly intended to create a right to contribution or indemnity.[11]

Consequently, a third party claim for indemnification cannot be implied under the Bankruptcy Code in a fraudulent conveyance action.

B. Contribution Under the Bankruptcy Code

As with indemnity, it is quite clear that no right of contribution exists under the Bankruptcy Code.[12] For example, in *Weiboldt Stores, Inc. v. Schottenstein*,[13] the chapter 11 trustee brought an action against certain individuals who were directors or selling shareholders of the debtor at the time of its acquisition in an LBO transaction. In response, those defendants brought a third party action for contribution against certain other entities involved in the acquisition, including individuals who assumed control of the board of the debtor after the acquisition and the lenders who financed the acquisition. In order to determine whether an implied right to contribution could be found in the Bankruptcy Code, the district court in *Weiboldt* turned to the four-part test set forth by the Supreme Court in *Cort v. Ash*.[14] The *Cort* test examines the following factors to determine whether a private remedy is implicit in a statute not expressly providing for such: 1) is the plaintiff "one of the class for whose especial benefit the statute was enacted," 2) does either explicit or implicit legislative intent create a remedy of contribution, 3) is the proposed remedy consistent with the underlying purpose of the legislation, and 4) is the cause of action in question traditionally relegated to the states, "so that it would be inappropriate to infer a cause of action based solely on federal law."[15]

The court in *Weiboldt* then applied this test to the contribution claims of the third party plaintiffs in the fraudulent conveyance action there as follows:

> Regarding the first part of the *Cort v. Ash* test, the language of the Bankruptcy Code in no way indicates that the Code was enacted for the special benefit of a claim of which the third-party plaintiffs are members. Section 548 of the

[11] *Peterson*, 56 B.R. at 591, n.5 (citations omitted).

[12] *Id. Weiboldt Stores*, 111 B.R. at 168; Airport Center Associates (*In re* Integrated Resources, 90 B. 10411, Adv. No. 91-5114A (Unpublished Decision Sept. 4, 1991)).

[13] 111 B.R. 162 (N.D. Ill. 1990).

[14] 422 U.S. 66 (1975).

[15] *Id.* at 78 (citations omitted).

> Code allows a trustee simply to avoid certain "fraudulent" transfers; it gives no indication, express or implied, of where ultimate financial responsibility for wrongful transfers should lie. In fact, by allowing a trustee to recover improperly distributed assets Section 548 of the Bankruptcy Code benefits a debtor's unpaid creditors at the *expense* of the recipients of fraudulent transfers.
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> The third-party plaintiffs correctly note that under Section 502 of the Code they may file claims against the estate to recover any voided transfers. However, this alone is insufficient to indicate that Congress enacted Section 548 for the *special* benefit of transferees of fraudulent conveyances. Indeed, any Congressional concern over the rights of transferees of fraudulently conveyed property could be peripheral at best.
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> Similarly, the second part of the *Cort v. Ash* test — legislative intent — does not support an implied right to contribution. As already noted, nowhere in the Bankruptcy Code did Congress expressly create or even mention a right to contribution. Additionally, as the third-party plaintiffs concede, there is no reference in the legislative history of Section 548 either favorable or unfavorable to contribution. This court agrees with the court in *In re John Peterson Motors, Inc.* when it concluded: "There is certainly nothing in title 11 [the Bankruptcy Code] to suggest that Congress expressly or implicitly intended to create a right to contribution or indemnity."
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> Thus, the third-party plaintiffs are not members of the class for whose especial benefit the Bankruptcy Code was enacted and there is no indication that Congress intended to create a right to contribution. Failure to satisfy these first two parts of the *Cort v. Ash* test dooms judicial recognition of an implied right to contribution under the Bankruptcy Code. Because Congressional intent to create a right to contribution cannot be inferred from the language of the Bankruptcy Code, the Code's structure, or any other source, the "essential predicate" for implication of a cause of action for contribution simply does not exist.[16]

Consequently, based on the reasoning of *Weiboldt*, no third party claim for contribution can be implied under the Bankruptcy Code in a fraudulent conveyance action.

C. *Indemnity and Contribution Under Federal Common Law*

Nor does federal common law recognize a right to indemnification or contribution. As the *Peterson* court articulated:

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[16] *Weiboldt*, 111 B.R. at 167-68 (citations omitted).

> There is no federal general common law . . ., and "[a]bsent some Congressional authorization to formulate substantive rules of decision, federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of states or our relations with foreign nations, and admiralty cases."[17]

Thus there simply is no basis on which a right of indemnification or contribution can be found under federal common law. When asked by the third party plaintiffs in *Weiboldt* to fashion such a remedy under federal common law, the district court refused explaining, "in enacting the Bankruptcy Code Congress created a comprehensive legislative program providing for no right to contribution. This court refuses to fashion a new remedy that might disturb this carefully considered legislative scheme."[18] There is no reason to think that other courts will find differently.[19]

The rationale of *Northwest Airlines, Inc. v. Transport Workers Union of America*,[20] on which the *Weiboldt* court relied in finding no right to contribution under federal law, would likewise bar claims for indemnity. "As with contribution, such claims could only arise by implication under the statutes or under common law principles, and the same arguments would preclude recognition of indemnity under either theory."[21]

II. Indemnification and Contribution Under New York Law

A. *Indemnification and Contribution Under the New York Debtor and Creditor Law*

There is neither an express nor implied right of indemnification or contribution in Article 10 of the Debtor & Creditor Law,

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17 *Peterson*, 56 B.R. at 591 n.5 (citations omitted).

18 451 U.S. 77 (1981).

19 Anderson v. Local Union, No. 3, International Brotherhood of Electrical Workers, 582 F. Supp. 627, 633 (S.D.N.Y.), *aff'd*, 751 F.2d 546 (2d Cir. 1984).

20 *Weiboldt*, 111 B.R. at 168 (citation omitted). Indeed, to permit an implied cause of action for indemnity or contribution under the Bankruptcy Code or federal common law would destroy the good faith defenses Congress has written into sections 548 and 550 of the Code, because a good faith transferee would be subject to suits for indemnity and contribution even though Congress clearly intended that it be free from attack against the transfer.

21 In Airport Center Associates, (*In re* Integrated Resources, 90 B 10411, Adv. No. 91-5114A (Unpublished Decision, Sept. 4, 1991)), the court also declined an invitation to fashion an equitable remedy to permit indemnification or contribution.

New York's codification of the UFCA.[22] Following the test in *Cort v. Ash*, the New York Court of Appeals has held that in determining whether a private cause of action for contribution or indemnification exists, a court must not look solely to whether the plaintiff is included in the class which the statute was enacted to benefit, but to legislative intent and the consistency of such a remedy with the underlying purposes of the legislation.[23] As the New York Court of Appeals explained: "[A] private cause of action is implied where it can be shown that plaintiff belongs to the class of legislatively intended beneficiaries and that a right of action would be 'clearly in furtherance of the legislative purpose.' "[24]

Parties to an LBO who are named as defendants in a fraudulent conveyance action, however, clearly do not belong to the class of legislatively intended beneficiaries of the New York Debtor and Creditor Law. That statute is intended to protect unpaid creditors from fraudulent transfers,[25] by permitting them to reach the assets of the transferee.[26] It is not intended to protect those who benefit from such transfers. Consequently, defendants in such actions can hardly claim to be a part of the class for whose special benefit the statute was enacted and the inquiry need go no further. Indeed, there is no basis on which a court can imply a cause of action for indemnification or contribution under the New York Debtor and Creditor law.

B. Indemnification Under New York Common Law

1. Implied-In-Fact Indemnification

Under New York law, absent an express indemnification agreement, an implied right to indemnification may be found based on a special relationship between the parties.[27] Thus, in

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22 N.Y. DEBTOR & CREDITOR LAW § 270 *et seq.* (McKinney Supp. 1993).

23 Burns Jackson Miller Summit & Spitzer v. Lindner, 59 N.Y.2d 314, 325, 451 N.E.2d 459, 463 (1983) (citations omitted). In *Lindner*, the court held that law firms damaged by a transit strike had no implied cause of action against labor unions under New York State's Taylor Law. *See* N.Y. CIVIL SERVICE LAW § 210 (McKinney Supp. 1993) (prohibiting strikes by public employees). *See also* CPC Int'l, Inc. v. McKesson Corp., 70 N.Y.2d 268, 276, 514 N.E.2d 116, 119 (1987) (no implied cause of action for breach of the anti-fraud provisions of New York's Martin Act, the state "Blue Sky" law).

24 *CPC Int'l, Inc.*, 70 NY.2d at 276, 514 N.E.2d at 119.

25 Pappo Bros. v. Thompson, 214 N.Y.S.2d 13, 15 (Sup. Ct. Nassau Cty. 1961).

26 California Airparts Corp. v. Rubino, 192 N.Y.S.2d 180, 184 (Sup. Ct. N.Y. Cty. 1959).

27 *See* Peoples' Democratic Republic of Yemen v. Goodpasture, Inc., 782 F.2d

Cohn v. Lionel Corp.,[28] the New York Court of Appeals allowed a cause of action for implied-in-fact indemnity where the plaintiff unequivocally asserted that he undertook the obligation for which he thereafter sought indemnification in his capacity as an agent for the defendant. In support of its holding, the court noted the general rule that where an agent is directed by a principal to do an act on the principal's behalf, "the law implies a promise of indemnity by the principal for damages resulting from or expenditure incurred as a proximate consequence of the good faith execution of the agency."[29]

In the case of a lending bank and the selling shareholders of the target corporation in the LBO scenario, however, no special relationship exists. The relationship between a borrower and its bank is simply that of debtor and creditor.[30] While there is certainly a fiduciary relationship between an officer of a corporation and the corporation's shareholders, there is no similar relationship between a bank and its borrower's shareholders.[31] The lending relationship between a bank and a corporation is a product of arm's length bargaining. Indeed, "it would be anomalous to require a lender to act as a fiduciary for interests on the opposite side of the negotiating table."[32] The same applies with equal force in the relationship between a lender and the selling shareholders of the target in an LBO. To imply an indemnity in such a case in favor of either party would make the other an indemnitor simply by virtue of having been a party to the LBO. Thus, in the

346, 351 (2d Cir. 1986) (citations omitted) ("an implied right to indemnification may be based on the special nature of a contractual relationship between the parties. . . . This has been called an 'implied contract theory' of indemnity . . . or an 'implied in fact' indemnity").

28 21 N.Y.2d 559, 236 N.E.2d 634 (1968).

29 *Id.* at 562-63, 236 N.E.2d at 637 (quoting 3 C.J.S. AGENCY § 197).

30 *See, e.g.*, Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, N.A., 731 F.2d 112, 122 (2d Cir. 1984) ("New York law is clear that the usual relationship of bank and customer is that of debtor and creditor"); Germantown Savings Bank v. Goldstein, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,533, at 93,407 (S.D.N.Y. 1989) (relationship between lending bank and customer is not fiduciary or confidential).

31 Weinberger v. Kendrick, 698 F.2d 61, 79 (2d Cir. 1982), *cert. denied*, 464 U.S. 818 (1983).

32 *Id. See also* Peoples' Democratic Republic of Yemen v. Goodpasture, Inc., 782 F.2d 346, 351 (2d Cir. 1986). ("If an implied contract for indemnification were to be found [in a grain sales agreement], one would have to be found in nearly every commodities sale contract that lacked a clause excluding it, a result that would reverse all standard contract and indemnity law."); City & County Savings Bank v. M. Kramer & Sons, Inc., 43 Misc. 2d 731, 734, 252 N.Y.S.2d 224, 227 (Sup. Ct. Albany Cty. 1964) (ordinary sales of goods are not sufficient to give rise to claims for implied-in-fact indemnity).

typical LBO related fraudulent conveyance action against a lender or the target's selling shareholders,[33] no special relationship exists that would give rise to implied-in-fact indemnification.

2. Implied-in-Law Indemnification

In New York, a party must show that it would be compelled to respond in damages for the wrongful act of another in order to be entitled to implied-in-law indemnification. Indemnity is appropriate only if the party who seeks it is liable to a plaintiff based on non-delegable legal obligations, such as vicarious[34] or imputed[35] liability, and not due to any fault of its own.[36] If the party seeking indemnification is even partially at fault, indemnity cannot be implied.[37]

For a participant in an LBO (or any recipient of a fraudulent

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[33] In fact, if the selling shareholders are also officers and directors of the target, they have a fiduciary obligation to the target, or, if the target is insolvent, its creditors. Alpert v. 28 Williams St. Corp., 63 N.Y.2d 557, 568-69 (1984). If the target is insolvent, the fiduciary duty runs to the target's creditors. New York Credit Men's Adjustment Bur. v. Weiss, 305 N.Y. 1 (1953). *See* N.Y. BUS. CORP. LAW § 720 (McKinney Supp. 1993). The breach of this obligation could result in the denial of indemnity in any form, even contractual. *See* N.Y. BUS. CORP. LAW § 720 (McKinney Supp. 1993). Corporate fiduciaries may not exploit their position of trust for personal benefit. Diamond v. Oreamuno, 24 N.Y.2d 494, 497-98, 248 N.E.2d 910, 912 (1969). Courts, therefore, should not reward corporate fiduciaries who, for their own personal benefit, act in derogation of their fiduciary obligations, by permitting them indemnification for their wrongful conduct by participating in a fraudulent transaction.

[34] "Vicarious liability" is defined as:

> The imposition of liability on one person for the actionable conduct of another, based solely on a relationship between the two persons. Indirect or imputed legal responsibility for acts of another; for example, the liability of an employer for the acts of an employee, or, a principal for torts and contracts of an agent.

BLACKS LAW DICTIONARY 1566 (6th ed. 1990).

[35] "Imputed" is defined as:

> As used in legal phrases, this word means attributed vicariously; that is, an act, fact, or quality is said to be "imputed" to a person when it is ascribed or charged to him, not because he is personally cognizant of it or responsible for it, but because another person is, over whom he has control or for whose acts or knowledge he is responsible.

Id. at 758.

[36] Johnson Controls, Inc. v. Rowland Tompkins Corp., 585 F. Supp. 969, 973 (S.D.N.Y. 1984) (applying New York law). *See generally* Jordan v. Madison Leasing Co., 596 F. Supp. 707, 709 (S.D.N.Y. 1984) (applying New York law); Jakobleff v. Cerrato, Sweeney and Cohn, 97 A.D.2d 786, 468 N.Y.S.2d 894, 895 (2d Dep't 1983); Hanley v. Fox, 468 N.Y.S.2d 193, 194 (3d Dep't 1983); *see* Garrett v. Holiday Inns, Inc., 58 N.Y.2d 253, 262-63, 447 N.E.2d 717, 721-22 (1983).

[37] *See generally Hanley*, 468 N.Y.S.2d at 194; *Jordan*, 596 F. Supp. at 709; *Johnson Controls*, 585 F. Supp. at 973.

conveyance) to assert a third party claim for implied-in-law indemnification, he would have to show that he is being held liable in the fraudulent conveyance action solely for the wrongful act of another and not because of any fault of his own. Because of the nature of a fraudulent conveyance claim, however, a selling shareholder, even one who had no role in the LBO except to receive payment in exchange for the tender of the shares, cannot avail himself of implied-in-law indemnification. As the court in *Hearn 45 St. Corp. v. Jano*[38] explained:

> The gravamen of the cause of action in [a fraudulent conveyance avoidance action] is the ordinary right of the creditor to receive payment; this right has been implemented by the protection of legislation concerning the circumstances under which the creditor may avail himself of assets which the debtor has transferred to others. No deceptive or fraudulent act of the individual defendants, no wrongful co-operation of theirs in the acts by which the judgment debtor's property was transferred, lends weight to the plaintiff's cause of action. The plaintiff's right is complete without reference to the quality or character of the acts of the individual defendants.[39]

Thus, the simple receipt of payment by the selling shareholder in an LBO scenario[40] is this act for which the selling shareholder is sought to be held liable. He is not sought to be held vicariously liable for the act of another. Consequently, he may not seek implied-in-law indemnification from other parties to the LBO. Both the Bankruptcy Code and the Uniform Acts provide a defense to a transferee who acts in good faith.[41]

C. *Contribution Under New York Statutory and Common Law*

Article 14 of the Civil Practice Law and Rules (CPLR) codifies the holding of the New York Court of Appeals in *Dole v. Dow Chem. Co.*[42] and enacts the Uniform Contribution Among Tortfeasors Act in New York. CPLR section 1401 provides:

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[38] 283 N.Y. 139, 27 N.E.2d 814 (1940).

[39] *Id.* at 143, 27 N.E.2d at 816.

[40] Assuming receipt of payment by the selling shareholder constitutes a sufficient basis on which to find him liable for a fraudulent conveyance, which may not be the case. Kupetz v. Wolf, 845 F.2d 842 (9th Cir. 1988) (affirming dismissal under California's UFCA where the selling shareholder did not know that the buyer would grant a lien on the corporation's assets to secure debt incurred to purchase the shares).

[41] 11 U.S.C. § 548(c) (1988); UFCA § 3(a) ("good faith") & § 9(1) ("without knowledge of the fraud") (Master ed. 1985); UFTA § 8(a) (Master ed. 1985).

[42] 30 N.Y.2d 143, 282 N.E.2d 288 (1972).

> Except as provided in section 15-108 of the general obligations law, two or more persons who are subject to liability for damages for the same personal injury, injury to property or wrongful death, may claim contribution among them whether or not an action has been brought or a judgment has been rendered against the person from whom contribution is sought.[43]

In construing this language, the court of appeals has held that "the existence of some form of tort liability is a prerequisite to application of the statute."[44]

In New York, however, a fraudulent conveyance claim based on constructive fraud, the typical basis for a claim in the LBO scenario, does not sound in tort.[45] As the district court in *United States v. Franklin National Bank*[46] articulated, "[t]he mere existence in the complaint of allegations of 'wrongful conduct' by the grantee does not convert the action from one based upon the right of a creditor to set aside a fraudulent conveyance to one based upon a tort."[47] Instead, fraudulent conveyance claims are equitable or quasi-contractual in nature.[48] Because contribution is only permitted where the underlying claims sound in tort, and because a fraudulent conveyance action does not sound in tort, contribution is not available under New York law to a defendant in a fraudulent conveyance action.

Indeed, there is no reason to extend contribution rights beyond tort actions to contract actions or quasi-contract actions such as fraudulent conveyance actions. As the New York Court of Appeals has explained:

> The policy considerations that underlay *Dole*—the need to liberalize the inequitable and harsh rules that once governed contribution among joint tort-feasors—are not pertinent to contract matters. Parties to a contract have the power to specifically delineate the scope of their liability at the time the contract is formed. Thus, there is nothing unfair in defining a contracting party's liability by the scope of its promise as re-

[43] N.Y. Civ. Prac. L. & R. § 1401 (McKinney Supp. 1993).

[44] 71 N.Y.2d 21, 28, 517 N.E.2d 1360, 1364 (1987).

[45] *See generally* Hearn 45 St. Corp. v. Jano, 283 N.Y. 139, 143-44, 27 N.E.2d 814, 817 (1940); United States v. Franklin National Bank, 376 F. Supp. 378, 384 (E.D.N.Y. 1973); Weiboldt Stores, Inc. v. Schottenstein, 111 B.R. 162, 169 (N.D. Ill. 1990); Airport Center Associates (*In re* Integrated Resources, 90 B 10411, Adv. No. 91-5114A (Unpublished Decision, Sept. 4, 1991)).

[46] 376 F. Supp. 378 (E.D.N.Y. 1973).

[47] *Id.* at 382.

[48] *Weiboldt Stores*, 111 B.R. at 169; *Hearn*, 283 N.Y. at 144, 27 N.E.2d at 817.

flected by the agreement of the parties.[49]

CONCLUSION

It is precisely because the parties to an LBO are able to contract for indemnification[50] and contribution rights before the transaction takes place that they do not need such rights to be implied at law. The parties to an LBO are generally represented by competent counsel in these sophisticated, multimillion-dollar transactions that are memorialized in dozens of documents. They are surely able to bargain for indemnification or contribution rights before proceeding with the LBO. If they fail to do so, they are unlikely to evoke sympathy for their plight from the courts. Lenders, in particular, have an incentive to insist on indemnification from the other parties to the LBO. The lender does not reap the large profits from the transaction that the selling shareholders do, yet it risks the trustee's avoidance of its liens and the possible subordination of its claim if found liable for a fraudulent conveyance. Consequently, the lender should insist on contractual indemnification, or at least some form of contribution from the shareholders who are to receive the proceeds of the loan, before agreeing to finance the LBO.

It is not enough for the parties to an LBO to recognize the fraudulent conveyance risk inherent in an LBO and hope the transaction will survive scrutiny if it winds up in bankruptcy court. Rather, the parties must allocate the fraudulent conveyance risk among themselves when the LBO is negotiated. Failure to do so leaves the allocation process to the whim of the bankruptcy trustee when he chooses his quarry.

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49 Bd. of Educ. of Hudson City School Dist. v. Sargent, Webster, Crenshaw & Folley, 71 N.Y.2d 21, 29, 517 N.E.2d 1360, 1365 (1987).

50 *But see supra* note 33.