

1 UNITED STATES COURT OF APPEALS
2 FOR THE SECOND CIRCUIT

3 August Term, 2004

4 (Argued: December 10, 2004 Decided: April 1, 2005)

5 Docket No. 04-0214-bk

6 - - - - -x

7
8 In Re:

9 Sharp International Corp. & Sharp Sales Corp.,

10 Debtors.

11 _____
12 Sharp International Corp.,

13 Debtor-Appellant,

14
15 - v.-

16 State Street Bank and Trust Company,

17 Appellee.

18 - - - - -x

19 Before: OAKES, JACOBS, and CABRANES, Circuit Judges.

20 Appeal from an order entered in the United States
21 District Court for the Eastern District of New York (Trager,
22 J.), granting State Street Bank and Trust Company's motion
23 to dismiss Sharp International Corporation's complaint. The

1 judgment is affirmed.

2 PETER N. WANG, Foley & Lardner
3 LLP, New York, NY (Robert A.
4 Scher, Kimberly J. Shur, Foley &
5 Lardner LLP, New York, NY, on
6 the brief) for Debtor-Appellant.

7 JOHN M. CALLAGY, Kelley Drye &
8 Warren LLP, New York, NY (Neil
9 Merkl, David Zalman, Kelley Drye
10 & Warren LLP, New York, NY, on
11 the brief) for Appellee.

12 DENNIS JACOBS, Circuit Judge:
13

14 Over a period of years, debtor-appellant Sharp
15 International Corporation ("Sharp") was looted by its
16 controlling shareholders. Now, through its trustee in
17 bankruptcy, Sharp sues one of the company's former lenders,
18 State Street Bank and Trust Company ("State Street"), which
19 suspected the fraud and extricated itself in a way that,
20 according to Sharp, facilitated the victimization of other
21 lenders and the continued looting of Sharp itself. Sharp
22 seeks recovery of funds looted after State Street should
23 have sounded the alarm, as well as a loan repayment Sharp
24 made to State Street in that period.

25 Sharp appeals a December 5, 2003 order of the United
26 States District Court for the Eastern District of New York
27 (Trager, J.), granting State Street's motion to dismiss

1 Sharp's claims that State Street aided and abetted breaches
2 of fiduciary duty by Sharp's controlling shareholders, and
3 received a payment from Sharp that constituted a
4 constructive or intentional fraudulent conveyance. The
5 district court's order affirmed a July 30, 2002 order of the
6 United States Bankruptcy Court for the Eastern District of
7 New York (Craig, J.).

8 We conclude that Sharp has not pled facts that would
9 entitle Sharp to relief under any of the legal theories it
10 advances. The judgment of dismissal is affirmed.

11 BACKGROUND

12 On review of a motion to dismiss the complaint, we
13 assume the truth of the factual allegations; the following
14 facts are primarily drawn from Sharp's complaint. See
15 Lentell v. Merrill Lynch & Co., 396 F.3d 161, 165 (2d Cir.
16 2005).

17 Sharp was a closely-held New York corporation engaged
18 in the business of importing, assembling, and distributing
19 wrist watches, clocks, pens, and mechanical pencils. The
20 brothers Bernard, Herbert, and Lawrence Spitz purchased 100%
21 of Sharp in February 1993 and were the sole officers of the

1 company from then until October 1999. In January 1995, the
2 Spitzes sold 13% of Sharp to Bohorodzaner, Inc., which
3 secured a seat on the Sharp board and a variety of corporate
4 governance rights, including the right to inspect Sharp's
5 books and records. Bohorodzaner had no knowledge of the
6 Spitzes' fraud during the relevant time period.

7 The fraud started at some point prior to 1997,
8 continued through October 1999, and operated in two steps.

9 First, the Spitzes falsified sales, inventory, and
10 accounts receivable, and invented customers, in order to
11 report fictitious revenue on Sharp's nonpublic financial
12 records. According to the complaint, "[t]hrough
13 manipulations of this sort, the Spitzes caused Sharp to
14 fraudulently report that its net sales were \$52.1 million in
15 fiscal 1997 (when its actual sales were approximately \$24
16 million), \$80.2 million in fiscal year 1998 (when its actual
17 sales were approximately \$21 million), and \$118.1 million in
18 fiscal 1999 (when its actual sales were approximately \$19
19 million)." Compl. ¶ 14. These inflated revenue figures
20 were used to borrow "increasingly large sums of money from a
21 succession of banks and other lenders." Compl. ¶ 15.

22 At the second step of the fraud, the Spitzes looted the

1 fraudulently raised funds as well as other corporate
2 profits. In 1998 and 1999 alone, the Spitzes diverted more
3 than \$44 million from Sharp to their various entities.

4 Sharp began borrowing from State Street in November
5 1996, when State Street approved a \$20 million demand line
6 of credit secured by Sharp's (supposed) assets. In July
7 1998, Sharp raised an additional \$17.5 million through the
8 sale of subordinated notes to a group of investors,
9 including Massachusetts Mutual Life Insurance Company,
10 Albion Alliance Mezzanine Fund, L.P., Travelers Insurance
11 Company, and certain of their affiliates (collectively, the
12 "Noteholders").

13 Nancy Loucks, a Senior Vice President and Credit Risk
14 Officer at State Street, had lending responsibility over
15 Sharp. State Street began to suspect fraud in the summer of
16 1998, by reason (inter alia) of: (i) Sharp's refusal to
17 comply with accounting procedures required under the
18 Sharp/State Street loan agreement; (ii) Sharp's fast growth
19 and voracious consumption of cash; and (iii) Loucks's
20 experience with similar instances of corporate fraud,
21 including fraud at a company called PT Imports. During the
22 summer and fall of 1998, Loucks devoted more time to the

1 Sharp account than any of her other accounts. Twice State
2 Street took the "unusual step" of contacting Sharp's
3 customers directly to verify that they were, in fact,
4 purchasing Sharp products.

5 In the fall of 1998, Sharp was current in its loan
6 payments to State Street and well within its credit line
7 limits; based on Sharp's financials, the State Street loan
8 appeared to be over-secured. Nevertheless, in September
9 1998, Loucks took several precautionary measures. She (i)
10 assigned an employee from the State Street loan workout
11 department to assist with the account; (ii) hired outside
12 counsel specializing in troubled loans; and (iii) alerted
13 more senior State Street employees of her concerns.

14 In October 1998, State Street sought more information
15 from Sharp about its largest customers, and asked to see the
16 1998 work papers of Sharp's outside auditor, KPMG Peat
17 Marwick ("KPMG"). Also in October 1998, State Street's
18 outside counsel retained a firm specializing in financial
19 investigation, called First Security, to conduct a formal
20 investigation of Sharp. First Security's 60-page report,
21 presented in November 1998, heightened Louck's anxiety.

22 In November 1998, State Street: (i) requested formal

1 confirmations of Sharp's receivables (which the Spitzes
2 refused to give); (ii) reviewed checks passed through State
3 Street's "demand and deposit" account to see if any
4 substantial payments had been made to the Spitzes; and (iii)
5 requested Sharp's detailed accounts receivable statement and
6 cash receipts (which the Spitzes agreed to provide at first,
7 then refused). On November 18, 1998, Loucks received Dun &
8 Bradstreet reports on 18 of Sharp's purported customers.
9 One customer could not be located; one had been out of
10 business since 1991; others, to which Sharp claimed to sell
11 watches, were engaged in different lines of business
12 altogether. At this point, State Street concluded its
13 investigation of Sharp.

14 The nub of the complaint is that State Street then
15 arranged quietly for the Spitzes to repay the State Street
16 loan from the proceeds of new loans from unsuspecting
17 lenders, thus avoiding a repeat of the PT Imports losses:

18 State Street demanded and obtained Sharp's
19 agreement to secure new financing from investors
20 unaware of the fraud, and to use that financing to
21 pay off State Street's line of credit. In
22 exchange, State Street agreed to give Sharp until
23 March 31, 1999 to obtain this new financing and to
24 retire the State Street debt.

25 Compl. ¶ 50. Sharp promptly approached the Noteholders for

1 an additional \$25 million in financing (\$10 million more
2 than Sharp owed to State Street). While that transaction
3 went forward, State Street gave no warnings and blew no
4 whistles, ignored inquiring calls from the Noteholders,
5 preserved Sharp's line of credit when it had the right to
6 foreclose and pull the plug, and gave Sharp its needed
7 consent to the new indebtedness.

8 On March 23, 1999, the unsuspecting Noteholders
9 purchased an additional \$25 million in subordinated notes
10 from Sharp. Sharp paid State Street roughly \$12.25 million
11 from the proceeds, and the Spitzes gave personal promissory
12 notes for the remaining \$2.75 million of the State Street
13 debt.

14 In July 1999, KPMG refused to issue a 1999 audit
15 opinion on Sharp, withdrew its 1997 and 1998 audit opinions,
16 and terminated its engagement with the company. In
17 September 1999, the Noteholders commenced an involuntary
18 Chapter 11 bankruptcy proceeding against Sharp.

19 In November 2000, the bankruptcy court entered a \$44.38
20 million judgment against the Spitzes (and three of their
21 companies, jointly and severally). That judgment remains
22 unsatisfied. The Spitzes later pled guilty to criminal

1 charges of defrauding State Street and others. See Albion
2 Alliance Mezzanine Fund, L.P. v. State Street Bank & Trust
3 Co., No. 602711/01, slip op. at 6 (N.Y. Sup. Ct. Apr. 14,
4 2003) aff'd 2 A.D.3d 162, 767 N.Y.S.2d 619 (1st Dep't 2003).

5 On May 30, 2001, Sharp commenced this adversary
6 proceeding against State Street in the bankruptcy court,
7 claiming as damages \$19 million that the Spitzes looted in
8 the period between State Street's discovery of the fraud (in
9 November 1998) and the bankruptcy court's removal of the
10 Spitzes from Sharp's business operations (in October 1999),
11 as well as the \$12.25 million payment made to State Street
12 from the proceeds of the subordinated notes sold to the
13 Noteholders in March 1999. State Street moved to dismiss on
14 the grounds that the complaint: (i) failed to plead the
15 aiding and abetting of a breach of fiduciary duty under
16 Federal Rules of Civil Procedure 12(b)(6) and 9(b); (ii)
17 failed to state a claim for intentional or constructive
18 fraudulent conveyance; and (iii) was barred by the doctrine
19 of in pari delicto.

20 The bankruptcy court dismissed Sharp's complaint in its
21 entirety. As to the claim for aiding and abetting a breach
22 of fiduciary duty, the court ruled that Sharp failed to

1 plead that State Street had actual knowledge of the second
2 stage of the Spitzes' fraud (i.e., the looting), or that
3 State Street "participated in" or "induced" the Spitzes'
4 fraud. Sharp Int'l Corp. v. State Street Bank & Trust Co.
5 (In re Sharp Int'l Corp.), 281 B.R. 506, 515-17 (Bankr.
6 E.D.N.Y. 2002). The constructive fraudulent conveyance
7 claim was dismissed for failure to allege that State
8 Street's receipt of the March 1999 payment from Sharp was
9 not in "good faith"; and the intentional fraudulent
10 conveyance claim was dismissed for failure to allege "badges
11 of fraud." Id. at 517-24. The bankruptcy court did not
12 reach State Street's in pari delicto argument. Id. at 524.

13 Sharp appealed the bankruptcy court rulings to the
14 district court. Meanwhile, the Noteholders filed their own
15 suit against State Street in New York County Supreme Court,
16 alleging fraud, negligent concealment, and aiding and
17 abetting fraud.¹ On December 5, 2003, the district court

¹On April 14, 2003, while Sharp's appeal of the bankruptcy court's ruling was pending in the Eastern District, the New York Supreme Court dismissed the Noteholders' suit against State Street, on a motion for summary judgment, noting that "[d]iscovery in this action has not revealed any conduct by [State Street] more serious than that alleged in [Sharp's] adversary proceeding." Albion, slip op. at 14. On December 4, 2003, the First Department "unanimously affirmed" that ruling, "for the

1 affirmed the bankruptcy court's dismissal of Sharp's claims,
2 concluding that although Sharp had adequately alleged State
3 Street's actual knowledge of the Spitzes' entire two-step
4 scheme, Sharp had not alleged that State Street
5 "participated in" or "induced" the Spitzes' fraud, and
6 affirming the bankruptcy court in all other material
7 respects. See Sharp Int'l Corp. v. State Street Bank &
8 Trust Co. (In re Sharp Int'l Corp.), 302 B.R. 760 (E.D.N.Y.
9 2003). We affirm for substantially the same reasons as the
10 district court.

11 DISCUSSION

12 Sharp argues that the district court erred in
13 dismissing the claims that State Street: (i) aided and
14 abetted the Spitzes' breaches of fiduciary duty; and
15 received a payment from Sharp that constituted (ii) a
16 constructive fraudulent conveyance, or (iii) an intentional
17 fraudulent conveyance.

18 This Court reviews de novo a district court's grant of
19 a motion to dismiss, "a standard pursuant to which we accept

reasons stated by" the New York Supreme Court. Albion
Alliance Mezzanine Fund, L.P. v. State Street Bank & Trust
Co., 2 A.D.3d 162, 767 N.Y.S.2d 619 (1st Dep't 2003).

1 all of the plaintiffs' factual allegations as true and draw
2 all reasonable inferences in favor of the plaintiffs."

3 Mason v. Am. Tobacco Co., 346 F.3d 36, 39 (2d Cir. 2003).

4 "Dismissal is proper if, accepting all the allegations in
5 the complaint as true and drawing all reasonable inferences
6 in plaintiff's favor, the complaint fails to allege any set
7 of facts that would entitle plaintiff to relief." Emergent
8 Capital Inv. Mgmt., LLC v. Stonepath Group, Inc., 343 F.3d
9 189, 194 (2d Cir. 2003).

10 In considering claims based in New York law (as here),
11 this Court "determine[s] de novo what the law of New York
12 is." McCarthy v. Olin Corp., 119 F.3d 148, 153 (2d Cir.
13 1997). In making that determination, this Court "afford[s]
14 the greatest weight to decisions of the New York Court of
15 Appeals." Id. If the New York Court of Appeals has not
16 spoken, this Court may consider lower New York court
17 opinions as "'the best indicators'" of how the Court of
18 Appeals might decide an issue. Id. (quoting In re Brooklyn
19 Navy Yard Asbestos Litig., 971 F.2d 831, 850 (2d Cir.
20 1992)).

21 **A. Aiding and Abetting the Breaches of Fiduciary Duty**

1 Under New York law, there are three elements to a claim
2 for aiding and abetting a breach of fiduciary duty. The
3 first element is "a breach by a fiduciary of obligations to
4 another," of which the aider and abettor had "actual
5 knowledge." Kaufman v. Cohen, 307 A.D.2d 113, 125, 760
6 N.Y.S.2d 157, 169 (1st Dep't 2003) ("Although a plaintiff is
7 not required to allege that the aider and abettor had an
8 intent to harm, there must be an allegation that such
9 defendant had actual knowledge of the breach of duty."); see
10 also Wechsler v. Bowman, 34 N.E.2d 322, 326, 285 N.Y. 284,
11 291 (1941) ("Any one who knowingly participates with a
12 fiduciary in a breach of trust is liable for the full amount
13 of the damage caused thereby to the cestuis que trust.").
14 The second element is "that the defendant knowingly induced
15 or participated in the breach"; and the third element is
16 "that plaintiff suffered damage as a result of the breach."
17 Kaufman, 307 A.D.2d at 125; see also Wight v. BankAmerica
18 Corp., 219 F.3d 79, 91 (2d Cir. 2000) (reciting elements of
19 New York aiding and abetting a breach of fiduciary duty
20 law); S & K Sales Co. v. Nike, Inc., 816 F.2d 843, 847-48
21 (2d Cir. 1987) (same); Whitney v. Citibank, N.A., 782 F.2d
22 1106, 1115 (2d Cir. 1986) (same).

1 The bankruptcy judge and the district judge disagreed
2 regarding whether State Street had actual knowledge of both
3 steps of the Spitzes' fraudulent scheme; but we need not
4 reach that issue because we agree with both judges that the
5 complaint insufficiently alleges knowing inducement or
6 participation. Thus, for purposes of the current appeal, we
7 assume State Street knew about the looting as well as about
8 the use of phony books and records to obtain loans.

9 The district court and the bankruptcy court also
10 disagreed about the nature of the relevant fraud. The
11 bankruptcy court conceptually severed the Spitzes' fraud
12 into two distinct breaches of fiduciary duty: (i)
13 fraudulently borrowing funds on behalf of Sharp; and (ii)
14 looting those (and other) funds from Sharp. See Sharp Int'l
15 Corp. v. State Street Bank & Trust Co. (In re Sharp Int'l
16 Corp.), 281 B.R. 506, 515 (Bankr. E.D.N.Y. 2002) ("The fact
17 that a company is inflating its receivables does not
18 necessarily mean that the company's principals are looting
19 it."). The district court, however, viewed the Spitzes'
20 fraudulent activities as part of a single scheme. See Sharp
21 Int'l Corp. v. State Street Bank & Trust Co. (In re Sharp
22 Int'l Corp.), 302 B.R. 760, 771 (S.D.N.Y. 2003) ("The

1 fraudulent financial reporting through which the Spitzes
2 induced creditors to loan money to Sharp and the Spitzes'
3 embezzlement of those and other corporate funds were two
4 steps in a single scheme.").

5 We need not reconcile these perspectives. Regardless
6 of whether the Spitzes' numerous breaches of fiduciary duty
7 are best viewed as a single scheme or as several distinct
8 breaches, damages remains an element of the cause of action,
9 see S & K Sales, 816 F.2d at 847-48 ("The claimant must
10 prove . . . that the plaintiff suffered damages as a result
11 of the breach."), and the damages claimed by Sharp are
12 premised and calculated on the \$19 million that the Spitzes
13 looted from Sharp, not their fraudulent borrowing on Sharp's
14 behalf. See Compl. ¶ 58 ("Between November 1998, when State
15 Street discovered the Sharp fraud, and October 1999, when
16 [the trustee in bankruptcy] took over management of Sharp,
17 the Spitzes looted Sharp of more than \$19 million").
18 Therefore, Sharp has stated the claim that State Street
19 aided and abetted the Spitzes' breach of fiduciary duty to
20 Sharp if Sharp has alleged State Street's knowing inducement
21 of or participation in the breach committed by the Spitzes
22 that resulted in damages Sharp seeks--i.e., the \$19 million

1 that the Spitzes looted after Sharp allegedly should have
2 blown the whistle.

3 "Inducement" seems to be undefined under New York law,
4 but is a common enough term. See Black's Law Dictionary at
5 790 (8th ed. 2004) (defining "inducement" as "[t]he act or
6 process of enticing or persuading another person to take a
7 certain course of action"). "A person knowingly
8 participates in a breach of fiduciary duty only when he or
9 she provides 'substantial assistance' to the primary
10 violation." Kaufman, 307 A.D.2d at 126. Substantial
11 assistance may only be found where the alleged aider and
12 abettor "affirmatively assists, helps conceal or fails to
13 act when required to do so, thereby enabling the breach to
14 occur." See id. "[T]he mere inaction of an alleged aider
15 and abettor constitutes substantial assistance only if the
16 defendant owes a fiduciary duty directly to the plaintiff."
17 Id.; see also Diduck v. Kaszycki & Sons Contractors, Inc.,
18 974 F.2d 270, 284 (2d Cir. 1992) (under federal law, "[o]ne
19 participates in a fiduciary's breach if he or she
20 affirmatively assists, helps conceal, or by virtue of
21 failing to act when required to do so enables it to
22 proceed"), abrogated on other grounds as noted in Gerosa v.

1 Savasta & Co., 329 F.3d 317, 319 (2d Cir. 2003). Since
2 Sharp does not contend that State Street owed Sharp a
3 fiduciary duty, Sharp must allege that State Street
4 committed affirmative acts that furthered the Spitzes'
5 breaches of fiduciary duty to Sharp and caused Sharp the \$19
6 million loss.

7 The complaint cites five acts by State Street that are
8 alleged to satisfy these standards; we consider these acts
9 in turn. Ultimately, we conclude that the complaint says no
10 more than that State Street relied on its own wits and
11 resources to extricate itself from peril, without warning
12 persons it had no duty to warn.

13 Sharp first alleges that after learning about the
14 Spitzes' fraud, State Street demanded that Sharp obtain new
15 sources of financing to retire the State Street debt:

16 State Street demanded and obtained Sharp's
17 agreement to secure new financing from investors
18 unaware of the fraud, and to use that financing to
19 pay off State Street's line of credit. In
20 exchange, State Street agreed to give Sharp until
21 March 31, 1999 to obtain this new financing and to
22 retire the State Street debt.

23 Compl. ¶ 50.

24 This allegation cannot be characterized as either
25 participation or substantial assistance. Therefore, this

1 allegation assists Sharp only if it qualifies as an
2 inducement. No doubt, a request for repayment does exert
3 some sort of pressure, and any pressure can be seen as an
4 inducement, at least incrementally. But that is an
5 unhelpfully broad reading of inducement in this context.
6 The demand at issue was for no more than was owed: repayment
7 of Sharp's outstanding debt to State Street. State Street
8 had a right to foreclose (as the complaint alleges); yet
9 State Street evidently did not expect foreclosure to be
10 efficacious. Under the circumstances, the demand for
11 repayment of a bona fide debt is not a corrupt inducement
12 that would create aider and abettor liability.

13 On appeal, Sharp contends that State Street "demand[ed]
14 that the Spitzes obtain new financiers in exchange for State
15 Street's silence." (Emphasis added). However, the argument
16 that State Street offered its silence as an inducement runs
17 counter to the complaint, which affirmatively alleges that
18 "State Street elected not to confront the Spitzes with what
19 it knew." Compl. ¶ 48. The complaint alleges only that
20 State Street demanded that the Spitzes find other sources of
21 financing, a demand that was consistent with State Street's
22 contractual and legal rights. As the district court

1 observed, this request, without more, could not have
2 "induced" the Spitzes to commit a fraud that they had begun
3 long before. In any event, Sharp does not allege--and
4 logically cannot allege--that State Street's demand for
5 repayment induced the looters to loot, or to loot more.

6 Sharp further alleges that State Street:

7 (i) "deliberately concealed its knowledge of the fraud at
8 Sharp"; (ii) elected not to foreclose on the loan; and (iii)
9 "avoided the Noteholders' repeated attempts to reach" State
10 Street in order to discuss the Sharp credit. Compl. ¶ 17,
11 52-53. Artful pleading aside, all of these allegations come
12 down to omissions or failures to act: i.e., not revealing
13 what State Street knew and suspected, not foreclosing, not
14 responding to inquiries. As such they are not "substantial
15 assistance," as that term is elucidated in Kaufman:
16 "Substantial assistance occurs when a defendant
17 affirmatively assists, helps conceal or fails to act when
18 required to do so, thereby enabling the breach to occur."
19 307 A.D.2d at 126. Absent a duty to act,² the only action

²State Street had no affirmative duty under New York law to inform Sharp, Sharp's existing creditors, or Sharp's prospective creditors of the Spitzes' fraud. See Bank Leumi Trust Co. v. Block 3102 Corp., 180 A.D.2d 588, 589, 580 N.Y.S.2d 299, 301 (1st Dep't 1992) ("The legal relationship

1 prescribed is not to "affirmatively assist" or to "help
2 conceal," which is another form of assistance and is
3 likewise affirmative in nature. Under Kaufman, a company in
4 a position to thwart or expose a breach of fiduciary duty
5 may protect its interests by doing neither, sitting tight,
6 and being quiet. No doubt, State Street was hoping to be
7 replaced by a less cautious lender, and had no intention of
8 precipitating its own loss, but silence and forbearance did
9 not assist the fraud *affirmatively*.

10 Finally, Sharp alleges that State Street participated
11 in the Spitzes' fraud by providing State Street's
12 contractually required consent:

13 State Street further assisted the Spitzes' breach
14 of fiduciary duty by giving Sharp its express
15 written consent to the Noteholders' purchase of an
16 additional \$25 million of subordinated notes. At
17 the time it gave this consent, State Street knew
18 that the Noteholders were purchasing these notes
19 in reliance on Sharp's fraudulent representations
20 concerning the accuracy of its financial
21 statements. State Street further knew that its
22 consent to the transaction was contractually
23 required and that, absent its consent, the
24 transaction would not be consummated.

between a borrower and a bank is a contractual one of debtor
and creditor and does not create a fiduciary relationship
between the bank and its borrower").

1 Compl. ¶ 53. States Street's consent was not an inducement;
2 it merely removed an impediment. Nor did the consent
3 conceal the fraud. Kaufman, 307 A.D.2d at 126. The
4 remaining question is whether that consent constituted
5 "affirmative assistance."

6 State Street's grant of consent can be characterized as
7 affirmative: State Street was called upon to utter or write
8 a consent without which Sharp could not have borrowed
9 additional funds from the Noteholders. On the other hand,
10 State Street's consent was mere forbearance; it did no more
11 than remove a contractual impediment that was reserved to
12 State Street to invoke or not in its own interest. The
13 existence of that right did not entail a duty to consider
14 the interests of anyone else, and State Street's exercise of
15 that right to protect itself rather than its improvident
16 competitors did not constitute participation in the Spitzes'
17 fraud.

18 The nub of the complaint is that State Street knew that
19 there would likely be victims of the Spitzes' fraud, and
20 arranged not to be among them. On the one hand, this seems
21 repugnant; on the other hand, Loucks's discovery that Sharp

1 was rife with fraud was an asset of State Street, and State
2 Street had a fiduciary duty to use that asset to protect its
3 own shareholders, if it legally could. One could say that
4 State Street failed to tell someone that his coat was on
5 fire; or one could say that it simply grabbed a seat when it
6 heard the music stop. The moral analysis contributes
7 little.

8 Whatever Loucks and State Street knew about the
9 Spitzes' fraud, they had come by that information through
10 diligent inquiries that any other lender could have made.
11 Sharp fails to identify any duty on State Street's part to
12 precipitate its own loss in order to protect lenders that
13 were less diligent. All the allegations are in substance
14 the same: that State Street was in a position to blow the
15 whistle on the Spitzes' fraud, but did not; instead, State
16 Street arranged to extricate itself from the risk.

17

18 **B. Constructive Fraudulent Conveyance**

19 Sharp alleges that the company's April 1998 payment of
20 \$12.25 million to State Street, in partial satisfaction of
21 Sharp's then outstanding debt, constituted a constructive
22 fraudulent conveyance under certain provisions of the New

1 York Uniform Fraudulent Conveyance Act, N.Y. Debt. & Cred.
2 Law, §§ 272-75 (McKinney 2001) ("DCL"), New York's version
3 of the Uniform Fraudulent Conveyance Act ("UFCA").

4 "The UFCA identifies several situations involving
5 'constructive fraud,' in which a transfer made without fair
6 consideration constitutes a fraudulent conveyance,
7 regardless of the intent of the transferor." HBE Leasing
8 Corp. v. Frank, 48 F.3d 623, 633 (2d Cir. 1995) ("HBE
9 Leasing I"). Under the DCL, a conveyance by a debtor is
10 deemed constructively fraudulent if it is made without "fair
11 consideration," and (inter alia) if one of the following
12 conditions is met: (i) the transferor is insolvent or will
13 be rendered insolvent by the transfer in question, DCL
14 § 273; (ii) the transferor is engaged in or is about to
15 engage in a business transaction for which its remaining
16 property constitutes unreasonably small capital, DCL § 274;
17 or (iii) the transferor believes that it will incur debt
18 beyond its ability to pay, DCL § 275. (The provisions and
19 definitions are set out in the margin.³)

³DCL § 272 provides that: "Fair consideration is given for property, or obligation.

a. When in exchange for such property, or obligation, as a fair equivalent therefor, and in

1 Sharp fails adequately to allege a lack of "fair
2 consideration." See Atlanta Shipping Corp., Inc. v. Chem.
3 Bank, 818 F.2d 240, 248 (2d Cir. 1987) ("An essential
4 element of a claim pursuant to DCL §§ 273, 273-a, 274, 275
5 is lack of fair consideration.").

6 The fair consideration test "is profitably analyzed as

 good faith, property is conveyed or an antecedent
 debt is satisfied, or

 b. When such property, or obligation is received
 in good faith to secure a present advance or
 antecedent debt in amount not disproportionately
 small as compared with the value of the property,
 or obligation obtained."

 DCL § 273 provides that: "Every conveyance made and
every obligation incurred by a person who is or will be
thereby rendered insolvent is fraudulent as to creditors
without regard to his actual intent if the conveyance is
made or the obligation is incurred without a fair
consideration."

 DCL § 274 provides that: "Every conveyance made without
fair consideration when the person making it is engaged or
is about to engage in a business or transaction for which
the property remaining in his hands after the conveyance is
an unreasonably small capital, is fraudulent as to creditors
and as to other persons who become creditors during the
continuance of such business or transaction without regard
to his actual intent."

 DCL § 275 provides that: "Every conveyance made and
every obligation incurred without fair consideration when
the person making the conveyance or entering into the
obligation intends or believes that he will incur debts
beyond his ability to pay as they mature, is fraudulent as
to both present and future creditors."

1 follows: (1) . . . the recipient of the debtor's property[]
2 must either (a) convey property in exchange or (b) discharge
3 an antecedent debt in exchange; and (2) such exchange must
4 be a 'fair equivalent' of the property received; and (3)
5 such exchange must be 'in good faith.'" HBE Leasing Corp.
6 v. Frank, 61 F.3d 1054, 1058-59 (2d Cir. 1995) ("HBE Leasing
7 II") (emphasis omitted); see also Ede v. Ede, 193 A.D.2d
8 940, 941-42, 598 N.Y.S.2d 90, 92 (3d Dep't 1993) ("[F]air
9 consideration requires that the exchange not only be for
10 equivalent value, but also that the conveyance be made in
11 good faith.").

12 Sharp acknowledges that the payment at issue discharged
13 an antecedent debt and was made for a "fair equivalent"; but
14 contends that fair consideration is lacking because State
15 Street did not receive the payment in "good faith."⁴

16 Good faith is an elusive concept in New York's
17 constructive fraud statute. It is hard to locate that
18 concept in a statute in which "the issue of intent is
19 irrelevant." United States v. McCombs, 30 F.3d 310, 326 n.1
20 (2d Cir. 1994); see also HBE Leasing I, 48 F.3d at 633 ("[A]

⁴"Good faith" in a constructive fraudulent conveyance claim "is the good faith of the transferee." HBE Leasing II, 61 F.3d at 1059 n.5.

1 transfer made without fair consideration constitutes a
2 fraudulent conveyance, regardless of the intent of the
3 transferor."). Moreover, bad faith does not appear to be an
4 articulable exception to the broad principle that "the
5 satisfaction of a preexisting debt qualifies as fair
6 consideration for a transfer of property." Pashaian v.
7 Eccelston Props., 88 F.3d 77, 85 (2d Cir. 1996).

8 One exception has been recognized by the New York
9 courts to the rule that the repayment of an antecedent debt
10 constitutes fair consideration: where "the transferee is an
11 officer, director, or major shareholder of the transferor."
12 Atlanta Shipping, 818 F.2d at 249; see also HBE Leasing I,
13 48 F.3d at 634 ("New York courts have carved out one
14 exception to the rule that preferential payments of
15 pre-existing obligations are not fraudulent conveyances:
16 preferences to a debtor corporation's shareholders,
17 officers, or directors are deemed not to be transfers for
18 fair consideration.").

19 The only case found by us or the parties in which an
20 (allegedly) antecedent debt paid to an *outsider* was found
21 lacking in fair consideration is one in which the debtor
22 affirmatively swore that the transaction was intended to

1 evade his creditors. See Ede, 193 A.D.2d at 942 (holding
2 that fair consideration was lacking in the face of evidence
3 "which can admit of no finding other than . . . bad faith").
4 But a case such as Ede does not furnish a rule of decision
5 for detecting what constitutes bad faith.

6 The decisive principle in this case is that a mere
7 preference between creditors does not constitute bad faith:

8 [E]ven the preferential repayment of pre-existing
9 debts to some creditors does not constitute a
10 fraudulent conveyance, whether or not it
11 prejudices other creditors, because "[t]he basic
12 object of fraudulent conveyance law is to see that
13 the debtor uses his limited assets to satisfy some
14 of his creditors; it normally does not try to
15 choose among them."

16 HBE Leasing I, 48 F.3d at 634 (quoting Boston Trading Group,
17 Inc. v. Burnazos, 835 F.2d 1504, 1509 (1st Cir. 1987)). Nor
18 does it matter that the preferred creditor knows that the
19 debtor is insolvent:

20 [A] conveyance which satisfies an antecedent debt
21 made while the debtor is insolvent is neither
22 fraudulent nor otherwise improper, even if its
23 effect is to prefer one creditor over another. It
24 is of no significance that the transferee has
25 knowledge of such insolvency. Nor is the transfer
26 subject to attack by reason of knowledge on the
27 part of the transferee that the transferor is
28 preferring him to other creditors, even by virtue
29 of a secret agreement to that effect.
30

31 Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A., 191

1 A.D.2d 86, 90-91, 599 N.Y.S.2d 816 (1st Dep't 1993)

2 (internal citations and quotation marks omitted).

3 Here, the payment was on account of an antecedent debt,
4 was made to an outsider, and there is no admission of
5 subjective bad faith (if indeed that would matter). Sharp
6 argues, however, that it has alleged more than a mere
7 preference, or knowledge of the debtor's insolvency, because
8 it alleges that State Street knew that the funds used to
9 repay the State Street debt were fraudulently obtained.

10 This argument is unpersuasive. We adopt--as did the
11 district court--the First Circuit's conclusion in Boston
12 Trading, that a lack of good faith "does not ordinarily
13 refer to the transferee's knowledge of the source of the
14 debtor's monies which the debtor obtained at the expense of
15 other creditors." 835 F.2d at 1512 (emphasis omitted). As
16 the Boston Trading Court explained,

17 [t]o find a lack of "good faith" where the
18 transferee does not participate in, but only knows
19 that the debtor created the other debt through
20 some form of[] dishonesty is to void the
21 transaction because it amounts to a kind of
22 "preference" -- concededly a most undesirable kind
23 of preference, one in which the claims of
24 alternative creditors differ considerably in their
25 moral worth, but a kind of preference nonetheless.

26 Id.

1 Our adoption of the First Circuit's rule is consistent
2 with New York's policy in favor of national uniformity in
3 UFCA law. See HBE Leasing I, 48 F.3d at 634 n.8 ("In order
4 to promote a uniform national interpretation of the UFCA,
5 both this Circuit and the courts of New York have encouraged
6 recourse to the case law of other jurisdictions.") This
7 ruling is not, as Sharp suggests, inconsistent with our
8 observation in HBE Leasing I that "the statutory requirement
9 of 'good faith' is satisfied if the transferee acted without
10 either actual or constructive knowledge of any fraudulent
11 scheme." 48 F.3d at 636.

12 HBE Leasing I concerned the "collapsing" of
13 contemporaneous transactions coordinated to shield an
14 insolvent debtor's assets from bona fide creditors. Id.
15 HBE Leasing I held that "multiple transactions may be
16 collapsed and treated as phases of single transaction where
17 (1) consideration received in exchange for [the] initial
18 transfer of [the] debtor's property is reconveyed by [the]
19 debtor for less than fair consideration or with fraudulent
20 intent, and (2) [the] transferee of [the] initial conveyance
21 has actual or constructive knowledge of [the] scheme." HBE
22 Leasing II, 61 F.3d at 1062 (stating the holding of HBE

1 Leasing I); see also Orr v. Kinderhill Corp., 991 F.2d 31,
2 35 (2d Cir. 1993) (this Court "will not turn a blind eye to
3 the reality that" two conveyances "constituted a single,
4 integrated transaction"). In HBE Leasing I, the original
5 lender knew when it extended the credit to the borrower that
6 the funds advanced might not be used for legitimate
7 corporate purposes, and that knowledge was held to be
8 sufficient notice that the debtor "might improperly funnel"
9 the proceeds "to third parties." HBE Leasing I, 48 F.3d at
10 637. This rule has no applicability where, as here, it is
11 undisputed that State Street's loan was made in good faith
12 long before the purportedly fraudulent transfer. No ground
13 exists therefore to "collapse" that loan into other (non-
14 contemporaneous) bad-faith maneuvers.

15 Sharp has alleged State Street's knowledge that the
16 funds used to repay the preexisting debt were fraudulently
17 obtained. New York fraudulent conveyance law, however, is
18 primarily concerned with transactions that shield company
19 assets from creditors, not the manner in which specific
20 debts were created, see Boston Trading, 835 F.2d at 1510;
21 State Street's knowledge of the Spitzes' fraud, without
22 more, does not allow an inference that State Street received

1 the \$12.25 million payment in bad faith. Cf. Ede, 193
2 A.D.2d at 942 (holding that fair consideration was lacking
3 in the face of evidence "which can admit of no finding other
4 than . . . bad faith").

5 **C. Intentional Fraudulent Conveyance**

6 Sharp alleges that Sharp's \$12.25 million payment to
7 State Street is voidable as an intentional fraudulent
8 conveyance. Pursuant to DCL § 276:

9 Every conveyance made . . . with actual intent, as
10 distinguished from intent presumed in law, to
11 hinder, delay, or defraud either present or future
12 creditors, is fraudulent as to both present and
13 future creditors.

14 "[T]o prove actual fraud under § 276, a creditor must
15 show intent to defraud on the part of the transferor." HBE
16 Leasing II, 61 F.3d at 1059 n.5. "[W]here actual intent to
17 defraud creditors is proven, the conveyance will be set
18 aside regardless of the adequacy of consideration given."
19 McCombs, 30 F.3d at 328. As "actual intent to hinder,
20 delay, or defraud" constitutes fraud, Atlanta Shipping, 818
21 F.2d at 251, it must be pled with specificity, as required
22 by Fed. R. Civ. P. 9(b). Moreover, "[t]he burden of proving
23 'actual intent' is on the party seeking to set aside the

1 conveyance." McCombs, 30 F.3d at 328.

2 "Due to the difficulty of proving actual intent to
3 hinder, delay, or defraud creditors, the pleader is allowed
4 to rely on 'badges of fraud' to support his case, i.e.,
5 circumstances so commonly associated with fraudulent
6 transfers that their presence gives rise to an inference of
7 intent." Wall St. Assocs. v. Brodsky, 257 A.D.2d 526, 529,
8 684 N.Y.S.2d 244, 247 (1st Dep't 1999) (internal citations
9 and quotation marks omitted). These "badges of fraud" may
10 include (inter alia): "a close relationship between the
11 parties to the alleged fraudulent transaction; a
12 questionable transfer not in the usual course of business;
13 inadequacy of the consideration; . . . and retention of
14 control of the property by the transferor after the
15 conveyance." Id.; see also HBE Leasing I, 48 F.3d at 639
16 ("Actual fraudulent intent . . . may be inferred from the
17 circumstances surrounding the transaction, including the
18 relationship among the parties and the secrecy, haste, or
19 unusualness of the transaction."); In re Kaiser, 722 F.2d
20 1574, 1582-83 (2d Cir. 1983).

21 Sharp argues that the district court inappropriately
22 focused on "badges of fraud" even though the Spitzes' fraud

1 was so clearly established that it need not be detected by
2 indicia. However, the intentional fraudulent conveyance
3 claims fails for the independent reason that Sharp
4 inadequately alleges fraud with respect to the transaction
5 that Sharp seeks to void, i.e., Sharp's \$12.25 million
6 payment to State Street. See Boston Trading, 835 F.2d at
7 1510 ("Fraudulent conveyance law is basically concerned with
8 transfers that 'hinder, delay or defraud' creditors; it is
9 not ordinarily concerned with how such debts were created.")
10 (emphasis omitted).

11 The fraud alleged in the complaint relates to the
12 manner in which Sharp obtained new funding from the
13 Noteholders, not Sharp's subsequent payment of part of the
14 proceeds to State Street. The \$12.25 million payment was at
15 most a preference between creditors and did not "hinder,
16 delay, or defraud either present or future creditors." DCL
17 § 276; cf. HBE Leasing I, 48 F.3d at 640 (actual intent
18 adequately alleged where the payment in question
19 "effectively transferred substantial assets from the
20 corporation to [insiders]" with the potential intent of
21 defrauding future judgment creditors).

1 For the forgoing reasons, the judgment of dismissal is
2 affirmed.