

Creditor's misstep costs him judgment

In today's 7th U.S. Circuit Court of Appeals case, a debtor transferred his interest in the family home to his wife by quitclaim deed. The home was held in joint tenancy by the couple, but the husband wanted to avoid liability for a loan. The issue in the case is whether the transfer violated the Illinois Uniform Fraudulent Transfer Act, 740 ILCS 160/1 et seq.

MacDonald v. Estate of Gayton, 469 F.3d 1079 (7th Cir. 2006).

James MacDonald loaned Joseph Gayton \$325,000. On Feb. 2, 2001, before the loan was repaid, Joseph Gayton conveyed his interest in the family home to his wife, Monica Gayton, and recorded the transfer with the Recorder of Deeds in March 2001.

In August 2003, MacDonald, as trustee of the Walter Middleton Co. Retirement Plan, filed a diversity suit against Joseph Gayton for failure to repay the \$325,000 loan.

Gayton died on Nov. 26, 2003, with no assets.

In December 2003, the U.S. District Court entered judgment for MacDonald nunc pro tunc as of Oct. 28, 2003, for \$357,139.89.

In January 2004, MacDonald filed his action against the Gayton Estate and Monica Gayton under the Illinois Uniform Fraudulent Transfer Act, 740 ILCS 160/1 et seq., contending the transfer was fraudulent and should be set aside.

The U.S. District Judge Blanche M. Manning granted summary judgment for the defendants, holding that no relief was available to MacDonald because he had not recorded a lien against the Gayton family home prior to Joseph Gayton's death.

The 7th Circuit affirmed. Judge William J. Bauer, who wrote the opinion, said that even if the UFTA was violated, the failure to record a lien during Joseph Gayton's lifetime allowed his interest to pass in joint tenancy unencumbered to his wife.

Bauer began the 7th Circuit's consideration of the appeal by considering the provisions of the UFTA.

"The UFTA establishes a creditor's right to file an action to obtain the avoidance of a fraudulent transfer or obligation to the extent necessary to satisfy the creditor's claim. [740 ILCS 160/8(a)(1)]," Bauer wrote. "The UFTA states, in part, that '[a] transfer made or obligation incurred by a debtor is



Federal Courts

By Jay S. Judge

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fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (1) with actual intent to hinder, delay, or defraud any creditor of the debtor. [740 ILCS 160/5]."

Noting the relief provided under the UFTA, the court stated: "To the extent that a transfer is voidable in an action by a creditor, the creditor may obtain a judgment for the value of the asset transferred or the amount necessary to satisfy the creditor's claim, whichever is less. 740 ILCS 160/9(b). This judgment may be entered against either the first transferee of the asset or the person for whose benefit the transfer was made. 740 ILCS 160/9(b)(1)."

MacDonald contended on appeal that if he proved Joseph Gayton's transfer of his interest violated the UFTA, then he was entitled to a judgment against Monica Gayton to satisfy the judgment he had obtained.

Noting the legal effect of a transfer in violation of the UFTA, the court continued: "Assuming that Gayton's transfer of his interest in his family home was fraudulent, the UFTA would nullify the transfer and the property would be restored to the joint tenancy with right of survivorship. See *Gayton v. Kovanda*, 306 Ill.Dec. 530, 533, 857 N.E.2d 929, 932, 2006 WL 3026035 at 4, (Oct. 25, 2006) (stating that fraudulent transfer of a joint tenant's interest in property does not sever the joint tenancy) (citing *Gilbert Bros. Inc. v. Gilbert*, 258 Ill.App.3d 395, 196 Ill.Dec. 492, 630 N.E.2d 189 (1994)). In other words, we would treat the property as

though the fraudulent transfer had not occurred. (citing *DeMartini v. DeMartini*, 52 N.E.2d 138, 141, 385 Ill. 128, 134 (1943) (a fraudulent conveyance is void only as against creditors and the conveyance is treated as though it had not occurred))."

Refusing MacDonald's invitation not to follow the 1st District Appellate Court decision that a creditor could not reach property fraudulently transferred where no judgment lien was recorded before his death, Bauer noted the 7th Circuit defers to Illinois substantive law.

"Macdonald asks us to depart from the decision of the [1st District] in *Gayton v. Kovanda*," Bauer wrote, "which addresses the same issue raised in the instant appeal: Whether, pursuant to the UFTA, a creditor of [Joseph] Gayton may reach property fraudulently transferred to [Monica Gayton] to satisfy a judgment when the judgment lien was not recorded until after [Joseph] Gayton's death. 306 Ill.Dec. 530, 857 N.E.2d 929, 2006 WL 3026035. The Illinois appellate court, like the district court, answered this query in the negative. 306 Ill.Dec. at 533, 857 N.E.2d at 932, 2006 WL 3026035 at 4. Macdonald argues that the sole authority cited by the Illinois appellate court for its decision is Manning's slip opinion, which is the subject of the instant appeal. He further asserts that the Illinois appellate court offers no other analysis or explanation for the proposition that when [the husband] died, the property passed to [the wife] as a joint tenant through rights of survivorship. This argument not only misrepresents the basis of the Illinois appellate court's decision, which cited to Manning's opinion in further support of its decision rather than as the basis of its decision, it fails to recognize that we defer to an Illinois court's interpretation of state law."

The 7th Circuit found that because MacDonald failed to record a lien against the property before Joseph Gayton died, his interest passed to his wife as joint tenant; therefore, whether the transfer was contrary to the UFTA was a non-issue.

"After [Joseph] Gayton transferred his interest in the property to Monica [Gayton] and before his death, [the husband] and [the wife] held the property as joint tenants," Bauer wrote. "Once [he] died, his interest in the

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property passed to [the wife] as a joint tenant through rights of survivorship.

“For Macdonald to reach the property for the purpose of satisfying the \$357,139.89 judgment, he must have perfected a lien on the property while [Joseph] Gayton held an interest in the property. Under Illinois law, a judgment only becomes a lien on the real estate of the person against whom it is entered once the judgment is filed with the recorder of deeds in the county in which the real estate is located. Since

Macdonald did not record a lien against the property while [the husband] was alive, the property passed to [the wife] unencumbered by the judgment at [the husband's] death. Neither the UFTA nor the district court's entry of judgment nunc pro tunc cures Macdonald's inability to file a judgment lien while Gayton held an interest in the property.”

Therefore, the 7th Circuit affirmed the judgment of the district court for the defendants.