

Split Third Circuit Holds Transfer By Non-Debtor Cannot Be Fraudulent Transfer

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Refusing to rely on “equitable principles” when interpreting the Delaware Uniform Fraudulent Transfer Act (DUFTA), the Third Circuit (2-1 decision) in *Crystallex Int’l Corp. v. Petroleos De Venezuela, S.A, et als.* held that a transfer by a non-debtor cannot be a fraudulent transfer.

Lending credence to Mel Brooks’ immortal words: “It’s good to be the king,” or the president of Venezuela, Bolivarian Republic of Venezuela (Venezuela) expropriated Crystallex International Corp.’s (Crystallex) rights in a gold mine the company had spent approximately \$650 million developing. Eventually, the Venezuelan Central Bank purchased a 40% stake in the seized mine for \$9.5 billion.

Mineless, Crystallex filed for bankruptcy and commenced an arbitration before the World Bank, resulting in a \$1.2 billion victory against Venezuela. Undaunted, Venezuela refused to pay the award and stated that it would actively eschew making the payment. Venezuela then monetized its interest in CITGO Petroleum, its largest asset located in the United States, through a series of debt offerings and upstream dividends among a succession of directly and indirectly owned companies. These funds passed first through a series of US entities and then were transferred to the Venezuela national oil company, a foreign corporation.

Under applicable treaties, Venezuela could not be sued to disgorge the repatriated the money. Unable to pursue Venezuela, Crystallex sued PDV Holding, Inc. (PDVH) a top-level US entity and indirect subsidiary of Venezuela’s national oil company on an actual fraudulent transfer theory. PDVH moved to dismiss the lawsuit because Crystallex had failed to alleged that the transfer was made “by a debtor” as required under DUFTA. The District Court denied the motion and found that indirect transfers by instrumentalities of a debtor (explicitly recognizing that only Venezuela, and perhaps its alter ego in the form of the national oil company, was the debtor of Crystallex by virtue of the arbitration award) are actionable under DUFTA. The District Court also noted that DUFTA broadly provides for the application of the principles of law and equity in these situations.

Reversing the lower court, the Third Circuit noted the three necessary elements of a properly pled claim under DUFTA: (i) a transfer, (ii) by a debtor, (iii) with actual intent to hinder, delay or defraud a creditor.

Crystallex did not allege PDVH to be a debtor or to have any liability for the arbitration award. The Court found that the Delaware Chancery Court has held that a non-debtor cannot commit a fraudulent transfer (the Delaware Supreme Court has not decided the issue). Giving a nod to a fundamental precept of Delaware corporate law that parent and subsidiary corporations are separate entities, the Third Circuit refused to read “by a debtor” broadly enough to bring a non-debtor within the scope of DUFTA. The Court also noted that Crystallex did not allege any basis for piercing the corporate veil between PDVH and either Venezuela or its national oil company. Thus, there was no legal or factual basis for holding the subsidiary responsible for its parent’s debt

The Court then addressed alternative theories of non-debtor transferor liability, such as indirect transfers, aiding and abetting and conspiracy to commit fraudulent transfers. Again, citing Delaware Chancery Court law, the Third Circuit debunked these theories, noting, “Delaware courts have closed the door to non-debtor transferor liability under [DUFTA], and we are not free to open it.”

The dissent took issue with the majority’s statutory interpretation, believing that PDVH’s dividend to the national oil company at Venezuela’s request was an *indirect* transfer by a debtor. The dissent noted that a transfer includes “every mode, direct or *indirect* . . . of disposing of or parting with an asset or an interest in an asset.” The dissent believed that “even though [PDVH] was not a debtor to Crystallex, it clearly facilitated the fraudulent transfer and is therefore a proper defendant in this case.” The dissent disagreed with the majority’s view that the Delaware Chancery Court decisions support no liability under DUFTA.

Recognizing that DUFTA is “firmly grounded in principles of equity,” the dissent was “hard pressed to conceive of a scenario more worthy of a trial court’s invocation of its broad equitable powers under [DUFTA] than this one.” “[I]t cannot be that [DUFTA] . . . leaves . . . the victim of a purposeful and complicated fraud without any remedy for [PDVH’s] role in transferring \$2.8 billion out of the United States to avoid Venezuela’s creditors.” The dissent would have upheld the lower court’s dismissal of PDVH’s motion to dismiss and let the case move to trial.

The Third Circuit, as a court sitting in diversity, felt constrained to apply state law as interpreted by the courts sitting in that state. The Court could not “‘act as a judicial pioneer’ in a diversity case.” Therefore, non-debtors in Delaware are free to make transfers to debtors without concern for fraudulent transfer liability until the Delaware state courts say otherwise, or the Third Circuit has a change of heart.

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