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Uniform Voidable Transactions Act: One Year After the UFTA Amendments

Navigating New Rules for Choice of Law, Burdens of Proof, Reasonably Equivalent Value and More

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UNIFORM VOIDABLE TRANSACTIONS ACT: ONE YEAR AFTER THE UFTA AMENDMENTS

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I. Introduction:
The Uniform Fraudulent Transfer Act (“UFTA”) and its Predecessors

Voidable transfer law (a/k/a fraudulent conveyance law)

- Sets the limits of a debtor's right to deal with his property, as against his creditors.
- Plaintiff = unsecured creditor of the debtor.
- Remedies are against the transferee of the property, not the debtor.
- Basic remedy: "avoidance"
  - Avoidance = the aggrieved creditor may pursue the property in the hands of the transferee.
    - The transfer is nonetheless valid as between debtor and transferee.
- Alternative remedy: money judgment against the transferee for the lesser of (i) the value of the property, or (ii) the amount of the debt owed the aggrieved creditor.

What kind of a transfer is avoidable under voidable transfer law?

- **Primordial Rule:** a transfer made by the debtor with intent to "hinder, delay, or defraud" any creditor of the debtor
  - The rule, in this language, dates to Statute of 13 Elizabeth c. 5 (1571).
  - Unparalleled historical continuity, much historical gloss.
  - "Hinder, delay, **<u>OR</u>** defraud". The rule captures debtor behavior that "hinders" or "delays" creditors, even if it doesn't "defraud" them.
  - "Intent": what does it mean? Doesn't a person intend the obvious consequences of his acts?
    - "Badges of Fraud"
    - Presumptions. Some presumptions adopted by courts were so forceful that they were eventually codified as separate rules, notably…..
- **"Constructive Fraud":** transfer by debtor who is insolvent (or in comparable financial distress) and who does not receive reasonably equivalent value in exchange.
- **Insider Preference:** transfer by insolvent debtor on account of an antecedent debt owed to an insider who has reason to know of the debtor's insolvency.

Application to obligations

- Obligations, as well as property transfers, can be avoided under voidable “transfer” law.
- Most familiar application: “upstream” guaranty
  - That is, a guaranty by a corporate subsidiary of a debt owed by its parent.
  - If the sub

    (i) does not receive reasonably equivalent value for the guaranty (and a sub that makes an “upstream” guaranty does not inherently receive any benefit at all), and

    (ii) is insolvent or renders itself insolvent by making the guaranty,

  then the guaranty is avoidable under the “constructive fraud” rules.

Principal U.S. Codifications of Voidable Transfer Law (Outside of Bankruptcy) (1)

- Statute of 13 Elizabeth c. 5 (1571)
  - After the Revolution, all states carried it forward in their common law
- Uniform Fraudulent Conveyance Act ("UFCA") (1918)
  - In force in 25 jurisdictions when it was replaced by UFTA in 1984
  - Its provisions were adopted wholesale into the Bankruptcy Act's integral voidable transfer provision in 1938
  - First codification of the "constructive fraud" rules

Principal U.S. Codifications of Voidable Transfer Law (Outside of Bankruptcy) (2)

- Uniform Fraudulent Transfer Act ("UFTA") (1984)
  - Soon after the Bankruptcy Code (1978)
  - Quite similar to the UFCA
  - Not amended since its promulgation in 1984

Enactment status today

- UFTA: Enacted by 44 states, D.C. & V.I.
  - Generally quite uniform
  - Chief nonuniformities:
    - 17-odd states have substantively altered the uniform statute of limitations in UFTA § 9 (which is generally four years).
    - Four states, some big (AZ, CA, IN, PA), did not enact the insider preference provision (UFTA § 5(b))
- UFCA: Still in force in 2 states (NY and MD)
  - NY made two nonuniform changes to its enactment of the UFCA:
    - Mandatory attorney fees to creditor prevailing under primordial rule
    - Unique additional "constructive fraud" rule applicable to transfer made by debtor against whom a complaint has been filed.
  - Statute of limitations in NY:
    - Uniform text of UFCA contains no statute of limitations.
    - NY statute of limitations: generally 6 years. (NY C.P.L.R. § 213, subdiv. 1.)
- Remaining 4 states (AK, LA, SC, VA):
  Statute of 13 Elizabeth or do-it-yourself statutes

Voidable transfer law that applies if the debtor goes bankrupt

- Since 1898, federal bankruptcy law has provided for two rules of voidable transfer, as follows:
  - It allows the debtor’s trustee to employ state voidable transfer law to avoid prebankruptcy transfers.
    - Today: BC § 544(b); remedies in § 550.
  - It has its own integral voidable transfer provision that also may be used by the debtor’s trustee to avoid prebankruptcy transfers.
    - Today: BC § 548; remedies in § 550.

UFTA, UFCA, and the voidable transfer provision integral to federal bankruptcy law: Closely parallel for the most part

- Since 1938, the bankruptcy law's integral voidable transfer provision has closely tracked UFCA/UFTA (which closely track each other).
  - Main reason for preparing UFTA in 1984 was to conform state law more closely to the integral voidable transfer provision in the then-new Bankruptcy Code, enacted in 1978.
  - Cases applying the integral federal bankruptcy provision, UFTA, and UFCA freely cross-cite each other.

Major differences in voidable transfer exposure in and out of bankruptcy

- Statute of limitations (aka "reachback period")
  - State law: Under UFTA, typically 4 years. (UFTA § 9) (unchanged in 2014).
    - Extended by "discovery rule" for claim under the primordial rule
    - Applies to an action in bankruptcy based on state law
  - Action under BC § 548: 2 years (changed from 1 year in 2005)
    - 10 years if transfer is to asset protection trust "or similar device"
- Extent of remedy if the transfer is voidable
  - State law: the transfer is avoided only to the extent necessary to satisfy the claim of the plaintiff creditor. (UFTA § 7(a)(1)) (unchanged in 2014).
  - If debtor is bankrupt: the transfer is avoided *in toto*.
    - Infamous rule of *Moore v. Bay*, 284 U.S. 4 (1931).
    - Applies if the action is based on state law or is based on BC § 548.
- Bankruptcy defense for "charitable tithing" added in 1998
  - Applies if the action is based on state law or is based on BC § 548.
  - No analogue in UFTA. (Drafting committee rejected adding in 2014.)
  - Since 2012, 4 states (FL, GA, ID, MN) enacted defenses of this sort (differing significantly from each other and from the BC).

Effect of the 2014 amendments to UFTA on bankruptcy practice

- State law cannot alter federal bankruptcy law directly, of course.
- But:
  - Bankruptcy trustees often employ state voidable transfer law because of its longer reachback period.
  - The longstanding parallelism between UFTA/UFCA and federal bankruptcy law suggests that changes to UFTA may affect how bankruptcy courts interpret federal law.

II. The 2014 Amendments to the UFTA (renamed the **Uniform Voidable Transactions Act** (“**UVTA**”)): The Project

The 2014 Amendments Are Here

- Approved by Uniform Law Commission in July 2014.
- Official text available at the ULC's website:

  http://www.uniformlaws.org/Act.aspx?title=Voidable%20Transactions%20Act%20Amendments%20(2014)%20-%20Formerly%20Fraudulent%20Transfer%20Act
- Many (most?) states have already begun to study the amendments for purposes of enactment.
- As of December 18, 2015:
  - Enacted in eight states (CA, GA, ID, KY, MN, NC, ND, NM).
  - Bills introduced in four others (CO, IN, MA, NV).
  - See above website for current enactment status

Nature of the Amendment Project

- Not a comprehensive revision of the UFTA.
- Drafting committee’s mandate was limited to a few narrowly defined issues.
- Drafting committee was, however, authorized to revise the official comments as it saw fit.
- Drafting committee’s mandate was based on recommendations made by a study committee that operated 2011-12.
  - Study committee’s reports are on the ULC website.

Choice of law as the initial impetus

- Initial impetus for the amendment project: adding a choice of law rule to the statute.
- The following article, submitted to the Uniform Law Commission to support the establishment of the project, was the project's intellectual foundation <*modest cough*>:

  Kenneth C. Kettering, *Codifying a Choice of Law Rule for Fraudulent Transfer: A Memorandum to the Uniform Law Commission,* 19 AM. BANKR. INST. L. REV. 319 (2011).

Available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1920512

The article on the 2014 amendments:

Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act,* 70 BUS. LAW. 777 (2015).

Available at the ULC website, cited above, and at SSRN:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2541949

III. Main Features of the 2014 Amendments

Outline of the main features of the 2014 amendments

A. Choice of law
B. Burdens of proof and standards of proof
C. Definition of “insolvent”
D. Refinement of defenses provided by § 8
E. Application to “series organizations”
F. Retitling of the Act
G. Transition
H. *[Changes to Official Comments: Not discussed systematically in this program]*

A. Choice of Law

The present morass

- The original UFTA does not contain a choice of law provision, nor did the UFCA before it.
- Choice of law therefore is left to common law.

Choice of Law: *First Restatement* view

Restatement (First) of Conflict of Law (1934): Whether a transfer of property is voidable is governed by the law of the jurisdiction in which the property is located. (§§ 218, 257)

- Does not speak clearly to the situation in which the property is intangible.
- Results in application of different voidable transfer laws to different pieces of the same transaction, if the transaction involves transfer of property located in more than one jurisdiction. (E.g., typical leveraged acquisition).
  - R1st "expresses no opinion" on whether, for chattels, the governing law instead should be that of the jurisdiction from which the "entire unit is managed" in the case of a transfer of "an aggregate unit made up of a number of units, themselves aggregates." (§ 256, caveat)
  - This obscure reference, if applied, would appear to point to application of the law of the jurisdiction of the debtor's chief executive office.

The wildly divergent, and infinitely elastic, *Second Restatement* view

Restatement (Second) of Conflict of Laws (1971):

- Speaks only to land. (R2d § 223 & Intro. Note)
- Says that "ordinarily" the law of the situs of the land applies, but "on occasion" (not defined) courts "may" apply the choice of law methodology applicable to torts.
- Courts purporting to apply R2d to voidable transfer claims always ignore what it actually says and apply the R2d tort methodology, regardless of the nature of the property.
- Tort methodology of R2d §§ 6, 145: court is to determine governing law based on meditation upon two lists of at least 11 factors, all impressionistic, none controlling.
  - No *ex ante* predictability.

Result: Chaos

- The *Restatement* rules are (a) wildly divergent and (b) weakly defined.
- Courts in some states don't purport to follow either *Restatement* on choice of law.
- Results reached by courts are not only difficult to predict, but sometimes are downright bizarre.
  - For example . . . .

Terry v. June, 359 F.Supp.2d 510 (W.D. Va. 2005), *amended*, 420 F.Supp.2d 493 (W.D. Va. 2006)

- Clawback of distributions made to a "winning" investor in a Ponzi scheme.
- Court (sitting in VA) concluded that a voidable transfer claim is a tort for purposes of VA choice of law rules (per R2d), but under those rules a tort action is governed by the law of the place of the wrong (per R1st for torts).
- Hence, the court concluded, the controlling voidable transfer law is that of the jurisdiction in which the last event occurred that gave rise to the voidable transfer claim.
- Result: The court held that the voidable transfer action against the winning investor was:
  - Governed by FL law to the extent his distributions were paid by check drawn on the fraudster's FL bank;
  - Governed by MI law to the extent his distributions were paid by wire transfer to the investor's MI bank account; and
  - Governed by Bahamas law to the extent his distributions were paid to the investor's MI bank account through an account in the Bahamas.
- Is this a sensible way to run a legal system?

Object of the 2014 Amendments

- A main object of the 2014 amendments was to create a uniform and coherent choice of law rule for voidable transfers.
- That is a very good thing!
- The 2014 amendments should be enacted everywhere as soon as possible.
  - Call your state bar association today & demand it!
- But, of course, there are inherent limits to what a state law can do . . . .

Choice of law issues for voidable transfer will still exist in bankruptcy

- The 2014 amendments won't resolve all choice of law problems for claims brought in bankruptcy.
- Reason: Supreme Court has never said what choice of law rule a bankruptcy court should apply to an issue governed by state law.
- Lower federal courts are much divided on that point:
  - Some: bank'cy court must apply the choice of law rules of the state in which it sits (as with federal courts exercising diversity jurisdiction).
  - Some: bank'cy court must apply uniform federal choice of law rules.
  - Some: bank'cy court must apply the choice of law rules of the state in which it sits, unless a federal interest requires a different choice of law rule.
- Write your congressman, not the Uniform Law Commission.
- The new uniform and coherent state rule may induce federal courts to tag along.

2014 amendments:
The new choice of law rule (New § 10)

- A voidable transfer claim is governed by the law of the jurisdiction in which the debtor is "located" at the time the challenged transfer or obligation was made or incurred.
- "Located":
  - **Individual:** principal residence
  - **Organization with one place of business:** that place
  - **Organization with more than one place of business:** chief executive office
- Time of transfer/obligation: as per existing provision of the UFTA (§ 6).

Why this choice of law rule?

- It is the same as the baseline choice of law rule applicable to determining the priority of a security interest in intangible property. (UCC §§ 9-301(1), 9-307(b)).
- Voidable transfer law is just a species of priority rule:
  - UVTA: determines priority as between transferee & debtor's creditors
  - UCC §§ 9-301, 9-307: determine priority as between a security interest & another lien
- The UVTA rule omits glosses to the Article 9 rule that are aimed at matters of perfection rather than priority.
  - Examples:
    - Under Article 9 (but not UVTA), a debtor that is a domestic corporation or other "registered organization" is "located" in its jurisdiction of organization. (UCC § 9-307(e)).
    - Under Article 9 (but not UVTA), a debtor in a jurisdiction that lacks an Article 9-style filing system is "located" in the District of Columbia. (UCC § 9-307(c)).
  - These glosses are omitted from the UVTA rule because UVTA has no analogue to the Article 9 concept of "perfection".

The new choice of law rule is clean in practical application

- Under the new choice of law rule, it will never be the case that multiple state’s potentially differing voidable transfer laws will apply to the same transaction.
  - Contrast: a rule based on the situs of the transferred property.
  - Contrast: a rule that distinguishes between tangible and intangible, real and personal, etc.

UVTA “Location” is not BC “COMI”

- Chapter 15, added to the Bankruptcy Code in 2005 applies to transnational insolvency proceedings.
- It requires US courts to defer in various ways to a foreign insolvency proceeding in the jurisdiction of the debtor’s “center of main interest” (“COMI”).
- UVTA “location” is not BC “COMI”.
  - If the debtor is an organization, its jurisdiction of organization is irrelevant to its UVTA “location,” but is presumptively its “COMI.”
  - Consequences of BC “COMI” are quite different from the consequences of UVTA “location.”

Gaming the rule via "asset tourism"?

- What if individual flies to an asset haven (e.g., Cook Islands), takes an apartment for six months, and does massive transfers while there. Are they governed by the (farcical) voidable transfer laws of the Cook Islands?
- Likewise: corporation tries to establish chief executive office in the Cook Islands by flying in directors for each meeting, etc.
- Comment: "principal residence" and "chief executive office" are to be determined on the basis of genuine and sustained activity, not manipulations.
  – Though UVTA uses the same terms as Article 9, they need not necessarily be interpreted in the same way.
  – Debtors have more incentive and opportunity to undertake "asset tourism" to game voidable transfer law than to game secured transaction law, and courts should recognize that.

Is this comment sufficient protection against gaming the rule?

- Would it be better to have a choice of law rule with an escape hatch which provides that the ordinary rule is ignored if it would point to application of the law of an asset haven?
- Drafting Committee considered at length and decided not to do that.
  - Sometimes the law of an asset haven really is appropriate (e.g., if the debtor really does live there).
  - How would the statute define an “asset haven” for this purpose?
  - Might a U.S. state be an “asset haven”?

B. Burden of Proof and Standard of Proof

Burden of Proof

- UFTA currently says nothing about which party has the burden of persuasion as to the elements of the various claims and defenses that may be raised.
- 2014 amendments add comprehensive provisions on the subject.
  - UVTA §§ 2(b), 4(c), 5(c), 8(g), 8(h).
  - Allocate burden of persuasion in a natural way;
    no controversy at all in the drafting committee
  - In general, plaintiff creditor bears burden of persuasion as to elements of claim; defendant transferee bears burden of persuasion as to elements of defenses

Effect on presumptions (1)

- Courts in many jurisdictions have established nonstatutory presumptions on various matters.
- Can be quite important, given the elasticity of some statutory standards (“hinder, delay, defraud”; “reasonably equivalent” value) and the difficulty of proving others (“insolvent”).
- Diverse local presumptions undercut uniformity.
- Any presumption is in tension with the statutory allocation of the burden of proof.

Effect on presumptions (2)

- New Comment (11) to Amended § 4: The statutory allocation of the burden of proof does not preclude nonstatutory presumptions.
- But a presumption is suspect if it would:
  - Alter the statutory allocation;
  - Upset the policy of uniformity; or
  - Carry forward obsolescent principles.
- Example of presumption to be shunned: presumption that transferee bears the burden of persuasion as to debtor's solvency if a transfer is for less than reasonably equivalent value.

Standard of Proof

- Original UFTA says nothing about the required standard of proof.
- States are divided, particularly with respect to the standard of proof applicable to the primordial rule (intent to "hinder, delay, or defraud" creditors):
  - Some: ordinary "preponderance of evidence" standard
  - Some: extraordinary "clear and convincing evidence" standard
- 2014 amendments: preponderance of the evidence is sufficient for all claims and defenses.
  - UVTA §§ 4(c), 5(c), 8(h).

Why “preponderance” rather than “clear and convincing”?

- Reason: The “clear and convincing” standard applies to proof of common-law fraud.
- The primordial rule does not require intent to “defraud” creditors. It applies to a transfer that is made with intent to “hinder” or “delay” creditors.
- Moreover, the extraordinary standard of proof for common-law fraud originated in cases that were thought to involve a special danger that claims might be fabricated.
  – E.g., action to set aside or alter the terms of a written instrument; action for relief on a claim unenforceable at law for failure to comply with the Statute of Frauds or Statute of Wills.
- Claims under the Act aren’t like that; there is no special danger that claims under the Act will be fabricated.

C. Definition of “Insolvent”

Significant uses of "insolvent" in UFTA

- A transfer of property or incurrence of an obligation by a debtor is voidable under the "**constructive fraud**" rules if

  (i) the debtor receives less than reasonably equivalent value in exchange, and

  (ii) the debtor is "insolvent," or is rendered "insolvent" by the transfer or obligation. (UFTA § 5(a)).

- A transfer of property by the debtor is voidable under the "**insider preference**" rule if

  (i) the transfer is on account of an antecedent debt,

  (ii) the transferee is an insider of the debtor,

  (iii) the debtor is "insolvent," and

  (iv) the transferee has reason to know that the debtor is "insolvent". (UFTA § 5(b)).

- None of this changed by the 2014 amendments.

Definition of "insolvent" (UFTA § 2)

- Similar to definition in BC § 101(32)
- Basic definition (UFTA § 2(a)):
  Insolvent = assets less than debts, both at fair valuations.
- Basic definition isn't substantively changed by the 2014 amendments. But . . . .
  - Comment has always stated that "fair valuation" applies to debts as well as to assets; the amendments will tweak the statutory language to make that more apparent in the statutory text.
    - "Fair valuation" of debts: e.g., face amount of a contingent debt should be discounted to reflect probability of contingency occurring.
  - Amended comment notes that "fair valuation" for purposes of UVTA may differ from "fair value" for accounting purposes.
    - E.g., current accounting rules require "fair value" of debt to be its market value, and hence reflect discount to its face amount on account of the debtor's credit rating.
    - That's not appropriate for purposes of UFTA.

Presumption of insolvency

- Original UFTA § 2(b) provides that insolvency is presumed if debtor is not generally paying its debts when due.
  - No analogue in Bankruptcy Code definition of “insolvent”.
- The 2014 amendments do not substantively change § 2(b), but they do elevate to the statutory text two points previously relegated to the comments:
  - Failing to pay a debt on account of bona fide dispute doesn’t count
  - If the presumption is triggered, its effect is to shift the burden of persuasion on solvency to the defendant (i.e., transferee).
    - Compare Federal Rule of Evidence 301, under which a presumption is a “bursting bubble”.
      - Under Fed. R. Evid. 301, the effect of a presumption is to require the defendant to produce prima facie evidence to rebut the presumption, but the burden of persuasion remains on the plaintiff.

The special definition of “insolvent” for partnerships

- Original UFTA § 2(c) credits a partnership with the net worth of its general partners, as well as the partnership’s own assets.
  - BC § 101(32)(B) does likewise.
- The 2014 amendments delete § 2(c).
- Result: the basic definition of § 2(a) (assets less than debts) applies to partnerships.
- Hence the definition of “insolvent” for partnership will differ in UVTA and BC (unless and until BC is amended).

Reasons for deleting the special definition of “insolvent” for partnerships

- It is no longer the case that all general partners are liable for all obligations of the partnership.
  - E.g., limited liability partnerships
- More fundamentally, it doesn’t make sense to credit a partnership with the net worth of its general partners when a nonpartnership entity whose debts are guaranteed gets no credit for the net worth of its guarantor.

D. Refinement of defenses provided by § 8

The 2014 amendments refine three defenses, discussed in turn as D.1, D.2, and D.3

(D.1) Defense to claim of "actual fraud" for a good faith transferee who gives reasonably equivalent value (§ 8(a)) (1 of 3)

- Original UFTA § 8(a): if a debtor makes a transfer with actual intent to hinder, delay, or defraud creditors, the transferee has a complete defense if the transferee (i) took in good faith, and (ii) gave reasonably equivalent value.
  - Oddly, no parallel defense in the Bankruptcy Code.
- Section 8(a) as originally written does <u>not</u> require the reasonably equivalent value to go <u>to the debtor</u>.
- Should it?
  - Some provisions of UFTA count value only if it goes to the debtor.
  - E.g., under the "constructive fraud" rule of § 5(a), a transfer by an insolvent debtor is avoidable unless the <u>debtor receives</u> reasonably equivalent value in exchange.
- The 2014 amendments revise § 8(a) to make the defense applicable only if the value goes <u>to the debtor</u>.

(D.1) Example (2 of 3)

In re Chapman Lumber Co., 2007 WL 2316528 (Bankr. N.D. Iowa 2007)

- Debtor was lumber company; sole officer was Keith.
- Before debtor's bankruptcy filing Keith received $5800 of hair removal services from Rebeka, an unrelated innocent hair care professional.
- Keith paid Rebeka with checks drawn on the debtor's bank account.
- After debtor filed for bankruptcy, trustee brought a voidable transfer action against Rebeka to recover the payments, alleging that they were made with intent to hinder, delay, or defraud the debtor's creditors.
- Is Rebeka entitled to the § 8(a) defense?
  - She acted in good faith
  - She gave reasonably equivalent value for the payments (her services)
  - But the value didn't go to the debtor; it went to Keith.
- Court held: Rebeka <u>is</u> entitled to the § 8(a) defense.
- 2014 amendments: Rebeka is <u>not</u> entitled to the § 8(a) defense.
  - Post-2014, Rebeka would have to return the payments, <u>if</u> the payments were made with intent to hinder, delay, or defraud.

(D.1) Moral of the story (3 of 3)

- Strangely underlitigated.
  - Of the few courts that have dealt with § 8(a), a good number took for granted that the defense applies only if the value goes to the debtor.
- The 2014 change (if it is a change) means that Rebeka is at risk if she takes payment from someone other than the person to whom she provided services, and that someone had actual intent to hinder, delay, or defraud its creditors.
- But this is not a new risk. If the lumber company was <u>insolvent</u> when the checks were drawn, Rebeka would have to disgorge the payments on a theory of <u>constructive</u> fraud. (§ 5(a))
  - Reason: the services Rebeka provided, though reasonably equivalent to the payment she received, didn't go to the debtor.
  - The language of § 5(a) is clear that in an action under that provision, value given by the transferee counts only if it goes <u>to the debtor</u>.
  - Section 8(a) defense doesn't apply to constructive fraud.
  - Section 8(c) awards a good-faith transferee a lien for value given – but only if the value is <u>given the debtor</u>. Rebeka doesn't qualify.

(D.2) Exclusion of strict foreclosure from the safe harbor for Article 9 remedies (1 of 2)

- If insolvent debtor defaults on secured debt, and secured creditor exercises remedies against his collateral (e.g., by foreclosure sale), and a crummy price is realized, can that transfer be avoided under the constructive fraud rules?
- Original UFTA provides two safe harbors against avoidance, which overlap:
  - Section 3(b): transfer in a "regularly conducted, noncollusive" <u>foreclosure sale</u> on a mortgage, deed of trust or security agreement
    - Section 3(b) thus does not apply to execution sales, tax sales
  - Section 8(e)(2): <u>transfer resulting from enforcement of a security interest</u> in compliance with Article 9 of the UCC.
    - Unlike § 3(b), § 8(e)(2) is not limited to foreclosure sales
    - Limited to Article 9 security interests; hence applies only to personal property and fixtures

(D.2) Exclusion of strict foreclosure from the safe harbor for Article 9 remedies (2 of 2)

- 2014 amendments <u>exclude</u> from the Article 9 safe harbor (§ 8(e)(2)) the remedy of <u>strict foreclosure</u>
  - "Strict foreclosure" = the secured creditor retains the collateral in full or partial satisfaction of the debt.
- At least three states (CA, CT, PA) have already done this.
- Reason: Article 9 contains significant protection for the debtor's other creditors in the case of a foreclosure sale, because such a sale must be commercially reasonable.
- By contrast, there is no requirement of commercial reasonableness for a strict foreclosure. Strict foreclosure requires the debtor's consent, and Article 9 relies on the debtor withholding consent to protect any equity he has in the collateral.
- So if the debtor doesn't protect his equity, the interests of the debtor's other creditors are not clearly protected by Article 9.

(D.3) Section 8(b) defense for "subsequent transferees" (1 of 2)

- Original UFTA § 8(b) provides a defense for a "subsequent transferee" (that is, a transferee other than the first transferee) that takes in good faith and for value.
  - The defense also protects any later transferee from such a protected transferee, even if the later transferee didn't take for value.
- Derived from BC § 550(a), (b).

(D.3) Section 8(b) defense for "subsequent transferees" (2 of 2)

- 2014 amendments revise § 8(b) to follow more closely the language of BC § 550(a), (b).
  - Original text of § 8(b) is compressed language that looks like a typographical error.
- The amendments will make clear that, as under BC § 550(a), (b):
  - The § 8(b) defense applies if the plaintiff seeks recovery of or from the transferred property (by levy or otherwise), as well as if the plaintiff seeks a money judgment against the transferee.
  - If a later transferee from a protected transferee does not give value, he is entitled to the defense only if in good faith.

E. Application of voidable transfer law to “series organizations”

“Series organizations”: the next big thing in business organization law

- Idea: organic statute governing a noncorporate business organization authorizes it to establish one or more “series”, each having assets and liabilities separate from those of other series and those of the “mother ship” entity.
- Originated for use by mutual fund families, each fund established as a separate series.
- Now being used for more general purposes.
- Delaware has series provisions in its LLC, LP and statutory trust statutes.
- A committee is working to add series provisions to all uniform acts re: unincorporated business organizations.
- Many unanswered questions (e.g., will the liability shields be recognized in bankruptcy, or by other states).

Why do series organizations raise an issue under voidable transfer law?

- Reason: A series of a series organization might not be a legal entity, even though it has its own assets and its own debts.
  - If a series isn't a legal entity, then a transfer of property from Series A to Series B couldn't be challenged under the UFTA, which applies only to a "person" (= legal entity).
- But because a series has its own assets and its own debts, voidable transfer law <u>should</u> apply to transfers in and out of a series.
- Hence the amendments add a new Section 11 that provides that a "series" which indeed has its own assets and its own debts is to be treated as a "person" for purposes of the UVTA, even if it isn't a "person" for other purposes.

F. Retitling of the Act

~~Uniform Fraudulent Transfer Act~~

Uniform Voidable Transactions Act

- The 2014 amendments change the title of the Act from “Uniform Fraudulent Transfer Act” to “Uniform Voidable Transactions Act”.
- Not motivated by the relatively minor substantive changes made in 2014.
- Rather, the word “Fraudulent,” though sanctioned by historical usage, was a misleading description of the Act as originally written.

Fraud is not, and never has been, a necessary element of a claim under the Act

- The so-called “constructive fraud” rules have nothing to do with fraud of any kind.
- The primordial rule, applicable to a transfer made with intent to “hinder, delay, **or** defraud” any creditor, does not require a showing of fraudulent intent. Intent to “hinder” or “delay” suffices.
  - See, *e.g.*, *Shapiro v. Wilgus*, 287 U.S. 348, 354 (1932).
- The misleading emphasis on “fraud” in the title of the Act has led courts to apply to claims under the Act doctrines applicable to “fraud” that are not properly applicable to the Act.
  - Examples:
    - Requirement by some courts of “clear and convincing evidence”
      - Repudiated by the 2014 amendments
    - Application by some courts of heightened pleading standards
      - 2014 amendments add a comment discouraging this

“Transactions,” not “Transfer”

- Furthermore, the word “Transfer” in the current title of the Act is underinclusive, because the Act applies to incurrence of obligations as well as to transfers of property.

Name change is nothing new

- This body of law was known historically as "fraudulent conveyance."
  - The original uniform act, UFCA of 1918, was so titled.
- Original UFTA changed the name to "fraudulent transfer," to eliminate the misleading suggestion by the word "conveyance" that the Act is limited to real property.
- One more name change, to cure the misleading reference to "fraud", is not radical.

Related change: Correcting inconsistent terminology in the statutory text

- Original UFTA inconsistently uses different words to denote a transfer or obligation for which the Act provides a remedy.
  - Sometimes “voidable”
  - Sometimes “fraudulent”
- The 2014 amendments cause the Act to use “voidable” consistently.
- As with the change of title, no change in meaning is intended by this.

These changes in terminology do not change the meaning of the Act

- The comments to the Act have always emphasized that the Act is <u>not</u> the <u>exclusive</u> law on the subject of voidable transfers and obligations.
- New comment: These changes in terminology should not affect matters governed by law other than the Act, such as the following:
  - Third party liability on theories of aiding and abetting, civil conspiracy
  - Applicability of rules of professional conduct to a lawyer who facilitates a transfer voidable under the Act
  - Applicability of the crime-fraud exception to attorney-client privilege to communications between a lawyer and client relating to a transfer voidable under the Act
  - Applicability of criminal sanctions for making or facilitating the making of a transfer voidable under the Act

G. Transition

No special effective date; effect is to be strictly prospective

- The 2014 amendments do not contemplate any special effective date.
- The enacting bill in a given state should declare the amendments effective on a date reasonably soon after enactment – enough time for news of enactment to percolate to lawyers in the state before effectiveness.
- Legislative Note: The enacting bill should state that:
  - The amendments apply to transfers made and obligations incurred on or after the chosen effective date; and
  - The amendments do <u>not</u> apply to transfers made and obligations incurred <u>before</u> the chosen effective date.

“Be just before you are generous.”

JAMES JOYCE, *ULYSSES*

Part II, Episode 15 (Circe)