

Insolvency & Restructuring - USA

Changes to the Uniform Fraudulent Transfer Act approved

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October 10 2014

- Introduction**
- Change of name**
- Choice of law**
- Evidentiary matters**
- Defences**
- Other changes**

Introduction

In July 2014 the Uniform Law Commission⁽¹⁾ approved changes to the Uniform Fraudulent Transfer Act, including a change in title to the Uniform Voidable Transactions Act.⁽²⁾

The Uniform Fraudulent Transfer Act was itself a 1984 revision of the 1918 Uniform Fraudulent Conveyance Act, a codification of certain decisions applying the Statute of 13 Elizabeth.⁽³⁾ The Uniform Fraudulent Transfer Act was adopted in 43 states and the District of Columbia;⁽⁴⁾ the most notable exception is New York, which maintains a statute based on the Uniform Fraudulent Conveyance Act.

The Uniform Voidable Transactions Act (like its predecessors) declares rights and provides remedies under state law for unsecured creditors against transactions that impede them in the collection of their claims.⁽⁵⁾ It therefore provides that creditors can void transfers made or obligations incurred by debtors under various circumstances, including:

- if the debtor at issue made the transfer or incurred the obligation with the intent of hindering, delaying or defrauding any creditor; or
- if the debtor did not receive a reasonably equivalent value in exchange for the transfer or obligation and, after the transaction, was insolvent, was left with insufficient assets to operate its business or was unable to pay its debts as they became due.⁽⁶⁾

The Uniform Law Commission does not consider the changes to be a comprehensive revision of the Uniform Fraudulent Transfer Act, but rather a set of minor amendments, including:

- the change of name;
- the addition of a new section with a choice of law rule for claims governed by the act; and
- rules allocating the burden of proof and defining the standard of proof with respect to claims and defences under the act.⁽⁷⁾

Nonetheless it is clear that the commission is attempting to refocus the manner in which courts approach transactions which hinder or delay creditors, as can be seen in the portion of the Official Comments to the Act in which the commission addresses the mistaken tendency of courts to look at such transactions through a lens borrowed from common law fraud.⁽⁸⁾

Change of name

Although very few words in the act itself have changed, the name change from the Uniform Fraudulent Transfer Act to the Uniform Voidable Transactions Act is – as emphasised in the official comments – a key provision of the act. According to the drafters, the use of the word 'fraudulent' in the original title was a misleading description of the act and led to confusion, as "[f]raud is not, and never has been, a necessary element of a claim under the act".⁽⁹⁾

Further, this use of the term 'fraud' led to the use of shorthand terminology that further distorted understanding of the act, so that certain theories of recovery – such as those in Sections 4(a)(2) and 5(a) with no connection to fraud at all – became known as 'constructive fraud' while the primary theory of recovery under Section 4(a)(1) became known as 'actual fraud', even though it did not require proof of fraudulent intent, but merely proof of intent "to hinder, delay or defraud any creditor".⁽¹⁰⁾ The drafters therefore suggest that this phrase is best considered to be a single term of art describing a transaction that unacceptably contravenes norms of creditors' rights.⁽¹¹⁾

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Choice of law

The amendments include the addition of a Section 10, which sets forth a choice of law rule for claims in the nature of those governed by the act.⁽¹²⁾ The new rule states that a claim is governed by the local law of the jurisdiction in which the debtor is located when the voidable transaction occurs.⁽¹³⁾ This refers to substantive law, not the choice of law rules of that location.⁽¹⁴⁾ The rule is designed to be simple and predictable, and to avoid 'asset tourism'. That is, the location (residence for an individual, place of business for an organisation with one location or location of the chief executive office if the organisation has more than one place of business) will "be evaluated on the basis of authentic and sustained activity, not on the basis of manipulations employed to establish a location artificially".⁽¹⁵⁾

Evidentiary matters

The amendments add uniform rules allocating the burden of proof and defining the standard of proof with respect to claims and defences under the act. Sections 4(c), 5(c), 8(g) and 8(h) have been modified.⁽¹⁶⁾ Section 4, which sets forth how certain transfers or obligations are voidable as to present or future creditors, and Section 5, applicable to transfers by financially distressed debtors, allocate to the creditor the burden of persuasion as to the elements of its claim, requiring that the creditor prevail on a preponderance of the evidence.⁽¹⁷⁾

The official comments recommend that courts not apply non-statutory presumptions that reverse this allocation or otherwise dilute it, such as the obsolete presumption that the transferee of a gratuitous transfer bears the burden of persuasion as to the debtor's financial condition.⁽¹⁸⁾ In so doing, they reject case law which has imposed the 'clear and convincing evidence' standard typically applied to proof of common law fraud, because Section 4(a)(1) applies to a transaction that hinders or delays a creditor even if it does not defraud and thus shares few, if any, elements with common law fraud.⁽¹⁹⁾

The burdens of proof for the defences set forth in Section 8 have also been clarified in new Sections 8 (g) and (h). A transferee that seeks to argue that it took in good faith and for reasonably equivalent value, or pursuant to one of the other more specific defences (eg, enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code) bears the burden of proof.⁽²⁰⁾ However, if a creditor is seeking judgment for the value of the asset transferred or the amount necessary to satisfy its claim, it must prove the elements of its claim (except that the transferee or obligee retains the burden of proving that it was a good-faith transferee that took for value).⁽²¹⁾

In addition, the commission moved language from the comments regarding the presumption of insolvency for a debtor that is not paying its debts as they become due to Section 2(b), thereby imposing on a debtor against which the presumption of insolvency is directed "the burden of proving that the nonexistence of insolvency is more probable than its existence".⁽²²⁾

Defences

The revisions to the act also refine provisions relating to the defences available to transferees and obligees. For example, Section 8(a) of the Uniform Fraudulent Transfer Act provided a defence to an action under Section 4(a)(1) for a person that took in good faith and for reasonably equivalent value. Among other changes to Section 8, this defence has been modified so that the reasonably equivalent value must have been given to the debtor.⁽²³⁾

Other changes

Finally, the revised act also has a number of other minor changes. A special definition of insolvency for partnerships has been deleted;⁽²⁴⁾ a new Section 11 addressing the 'series organisation' as a form of business organisation has been added;⁽²⁵⁾ and the references in the act to a 'writing' were modernised and changed to 'record'.

The act does not address the extent to which there may be liability under other laws for those that facilitate a voidable transaction, such as aiding and abetting or civil conspiracy.⁽²⁶⁾

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Endnotes

(1) Also known as the National Conference of Commissioners on Uniform State Laws, the Uniform Law Commission drafts and proposes specific statutes in areas of the law where uniformity between the states is desirable. See "[About the ULC](#)". The uniform acts proposed by the Uniform Law Commission must still be adopted by state legislatures to become effective. *Id.*

(2) See the press release "[Uniform Law Commission Wraps Up 123rd Annual Meeting](#)" (July 22 2014); see also [Uniform Voidable Transactions Act \(Formerly Uniform Fraudulent Transfer Act\) \(Draft For Approval\)](#) (June 5 2014), Official Comment § 14.

(3) Draft act, Prefatory Note (1984) to the Uniform Fraudulent Transfer Act, at 1.

(4) Legislative Enactment Status of the Fraudulent Transfer Act (available at www.uniformlaws.org/Act.aspx?title=Fraudulent%20Transfer%20Act).

- (5) Draft act, Cmt 2 § 1.
- (6) See act §§ 4(a) and 5(a).
- (7) Press release; draft act, Cmt § 14.
- (8) Draft act, Cmt 8 § 4.
- (9) Draft act, Cmt 1 § 14.
- (10) See act §§ 4(a)(1), 4(a)(2) and 5(a) (emphasis added); draft act Cmt 1 § 14.
- (11) See draft act, Cmt 8 § 4.
- (12) Act § 10(b); draft act, Cmt 1 § 10.
- (13) Act § 10(b).
- (14) Draft act, Cmt 1 § 10.
- (15) Act § 10(a) and draft act, Cmt 3 § 10.
- (16) Draft act, Prefatory Note (2014 Amendments) at 5.
- (17) Act §§ 4(c) and 5(c).
- (18) Draft act, Cmt 11 § 4.
- (19) Draft act, Cmt 10 § 4.
- (20) Act §§ 8(a), 8(d), 8(e), and 8(g)(1).
- (21) Act § 8(g)(1)(2).
- (22) Draft act, Prefatory Note (2014 Amendments), at 5.
- (23) Act § 8(a). Other changes modify the defence that a security interest in compliance with Article 9 of the Uniform Commercial Code was being enforced. The act makes clear that acceptance of collateral in full or partial satisfaction of the obligation may be voidable. Act § 8(e)(2); draft act, Cmt 4 §8.
- (24) Draft act, Prefatory Note (2014 Amendments), at 5.
- (25) Act § 11. This provision is meant to accommodate developments in business organisation statutes which allow an organisation to divide its assets and debts among 'protected series'. See draft act, Cmt § 11. A 'series organisation' is, according to the definition in Section 11(a)(2) of the act, one with the following characteristics:

"(i) The organic record of the organization provides for creation by the organization of one or more protected series, however denominated, with respect to specified property of the organization and for records to be maintained for each protected series that identify the property of or associated with the protected series.

"(ii) Debt incurred or existing with respect to the activities of, or property of or associated with, a particular protected series is enforceable against the property of or associated with the protected series only, and not against the property of or associated with the organization or other protected series of the organization.

"(iii) Debt incurred or existing with respect to the activities or property of the organization is enforceable against the property of the organization only, and not against the property of or associated with a protected series of the organization."

Such a structure is provided for in, for example, the Delaware Limited Liability Company Act 2012:

"A limited liability company agreement may establish or provide for the establishment of 1 or more designated series of members, managers, limited liability company interests or assets. Any such series may have separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations, and any such series may have a separate business purpose or investment objective."

Del Code Ann tit 6 § 18-215 (2012).

- (26) Draft act, Cmt 5 §14.

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