**Recent Developments in Fraudulent Transfers**

**(Voidable Transactions)**

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**Background**

* We will use as our focus point the amendments to the Uniform Fraudulent Transfer Act (to be renamed the “Uniform Voidable Transactions Act”) promulgated in 2014 by the Uniform Law Commission
* We will discuss the significant amendment and add comments from the Minnesota perspective.

**Background of the Amendments**

* Project to amend the Uniform Fraudulent Transfer Act
* Historical antecedents to the Uniform Fraudulent Transfer Act
  + Roman law
  + Statute of 13 Elizabeth
  + Uniform Fraudulent Conveyance Act
    - promulgated in 1918
    - still in effect in Maryland and New York

**Background**

* Uniform Fraudulent Transfer Act
  + promulgated in 1984 to be more consistent with the Bankruptcy Code of 1978
  + adopted by Minnesota in 1987, with notable exception of the four-year statute of limitations provision
  + adopted in 43 states plus the District of Columbia and the U.S. Virgin Islands
  + Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, U.S. Virgin Islands, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming
* Other states
  + Alaska, Kentucky, Louisiana, South Carolina and Virginia.
  + Sui generis

**Relationship to the Bankruptcy Code**

* The Bankruptcy Code has its own fraudulent transfer statute – Section 548
  + No need to find an actual creditor to invoke the remedy
  + Generally a two-year look-back
* But the bankruptcy trustee can use non-bankruptcy law under Section 544(b)
  + Need to find an actual creditor
    - *Moore v. Bay*, 284 U.S. 4 (1931)
    - *In re Petters Company*, 494 B.R. 413  
      (Bankr. D. Minn. 2013)
  + Four-year look-back under the UFTA; Six years from discovery of fraud in Minnesota.   
    Minn. Stat. § 541.05, subd. 1(6)

**Protection of Creditors**

* From acts that go beyond the norms of the debtor-creditor relationship
  + A “creditor” is someone who has a “claim”
  + A “claim” is defined in Section 1(3) broadly as it is in the Bankruptcy Code
    - “A right to payment, whether or not right has been reduced to a judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.”

**Intentional Fraud**

* A transfer of property or the incurrence of an obligation by a debtor with the actual intent to hinder, delay or defraud the debtor’s creditors

**Constructive Fraud**

* The transfer of property or incurrence of an obligation by a debtor
  + for less than reasonably equivalent value, and
  + when the debtor is left
    - insolvent, or
    - with unreasonably small capital

**Status of Proposed Amendments**

* Approved at the ULC annual meeting on July 16, 2014
* The amendments will be presented to the states for the 2015 legislative sessions
* Drafts and memoranda available at the ULC’s website:

http://www.uniformlaws.org/Committee.aspx?title=Fraudulent%20Transfer%20Act

* The amendments are discrete, surgical strikes
* There is no one overall theme

**Choice of Law**

* Core issue driving the amendments because of lack of certainty *ex ante* and the possibility of fact-intensive litigation *ex post*

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)

* Points to the fraudulent transfer law of the location of the debtor at time of the transfer or the incurrence of the obligation
  + An individual debtor is considered located at his or her primary residence
  + A debtor that is an organization is considered located at its place of business or, if it has more than one place of business, at its chief executive office
* For time of transfer, see UFTA § 6
* Example
  + Debtor resides in State A
  + Anticipating divorce from Debtor’s spouse, Debtor transfers assets to a trust located in State B with special debtor protections
  + If a dispute arises in a forum in a jurisdiction in which the amendments are in effect, State A’s fraudulent transfer law applies to the transfer
* “Asset tourism” issue
  + Strong comments
* The amendments will not resolve all fraudulent transfer choice of law problems in a bankruptcy case
  + The Supreme Court has never said what choice of law rule a bankruptcy court should apply to an issue governed by state law
  + And lower federal courts are much divided on the issue:
    - Some bankruptcy courts apply the choice of law rules of the forum (as with federal courts exercising diversity jurisdiction)
    - Some apply uniform federal choice of law rules
    - Some apply the choice of law rules of the forum, unless a federal interest requires a different choice of law rule
  + The new choice of law rule may be instructive to a bankruptcy court that would not otherwise apply the choice of law rule of the forum
  + Implications for Minnesota if it continues to have a non-uniform statute of limitations

**Evidentiary Matters**

* New uniform rules allocating the burden of proof and defining the standard of proof with respect to claims and defenses under the Act.
* Generally, the burden of proof on asserting a fraudulent transfer claim is on the creditor, and the standard of proof is the preponderance of the evidence.
* Consistent with Minnesota Bankruptcy Court ruling in *Petters* cases.  
  *In re Petters Company*, 494 B.R. 413 (Bankr. D. Minn. 2013)
  + Bankruptcy Trustee must specifically plead a predicate creditor with standing to sue as of the petition date.
  + Bankruptcy Trustee must plead sufficient facts establishing constructive fraud under Fed. R. Civ. P. 8(a).

“Ponzi presumption” available to establish constructive and actual fraud

* As originally written, the Act sometimes inconsistently used the term “fraudulent” to refer to a transfer or obligation for which the Act provides a remedy.
  + This was the case even though fraud *per se* was not a requirement for application of the Act.
* The amendments substitute the word “voidable” for the word “fraudulent” in order more accurately to describe the transfer or obligation for which the Act provides a remedy.
* The title of the Act will be changed to the “Uniform Voidable Transactions Act”
* The change is consistent with
  + substitution of the word “voidable” for the word “fraudulent” throughout the text of the Act, and
  + with the Act historically covering the incurrence of obligations in addition to transfers of property
* The title has been changed before
  + “Conveyance” in UFCA to “Transfer” in UFTA

**Title of the Act/Terminology**

* Comments
  + The Act does not cover the entire subject of voidable transfers and obligations
* Comments
  + The changes in terminology do not affect other law
    - Third party liability for aiding and abetting or civil conspiracy
    - Rules of professional conduct for a lawyer who facilitates a transfer or obligation voidable under the Act
    - The crime-fraud exception to attorney-client privilege applicable to communications between a lawyer and client relating to a transfer or obligation voidable under the Act
    - Criminal sanctions for facilitating or making a transfer or obligation voidable under the Act

**Determining “Insolvency”**

* Clarifies that “debts” must be valued at fair value as well as assets
* Guidance in the comments
  + A contingent debt should be valued based on the likelihood that the contingency would occur
  + Avoid trading values or accounting valuations based on the likelihood of collection
* UFTA § 2(b) currently provides that insolvency is presumed if the debtor is not generally paying its debts when due
  + No similar presumption in the Bankruptcy Code
  + The amendments will move into the statute two points previously only in the comments:
    - Failing to pay a debt on account of bona fide dispute does not count as debt
    - If the presumption is triggered, its effect is to shift the burden of persuasion on solvency to the transferee

**Determining “Insolvency” for Partnerships**

* The original Act set forth a special definition of “insolvency” applicable to a partnership. Under this special definition the net assets of a general partner were counted as assets of the partnership for purposes of determining the partnership’s insolvency
* The amendments delete the special definition
* Variation from Bankruptcy Code § 101(32)(B)

The original definition could be justified only if each general partner were liable for all debts of the partnership. That is not the case under some modern partnership statutes such as those permitting limited liability partnerships.

* Moreover, the original definition seemed to treat a general partner as analogous to a guarantor of the partnership’s debts for purposes of determining insolvency but without similar treatment for a third party guarantor of the partnership’s debts.

**Defenses**

* As originally written, the Act created a complete defense to an intentional fraudulent transfer action if the transferee or obligee took in good faith and for a reasonably equivalent value
  + No equivalent defense in the Bankruptcy Code
* The amendments add that the reasonably equivalent value must be given to the debtor
  + This amendment would produce a different outcome than in *In re* Schultz, 368 B.R. 832 (Bankr. D. Minn. 2007); *In re Chapman Lumber Co.,* 2007 WL 2316528 (Bankr. N.D. Iowa 2007)
* As originally written, the defense for a subsequent transferee that took in good faith and for value, and for a subsequent transferee from that transferee, literally applied only to an action for a money judgment
* The amendments provide, consistent with §§ 550(a) and (b) of the Bankruptcy Code, that the defense also applies to recovery of or from the transferred property or its proceeds, by levy or otherwise
* As originally written, the Act created a defense to a fraudulent transfer, other than an intentional fraudulent transfer, if the transfer resulted from the enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code
* The amendments exclude from that defense acceptance of collateral in full or partial satisfaction of the secured obligations (a so-called “strict foreclosure”)

**Series Organizations**

* A new section of the Act provides that each “protected series” of a “series organization” is to be treated as a separate person for purposes of the Act, even if the series is not treated as a legal entity for other purposes.
* This change responds to the emergence of the “series organization” as a common form of business organization
* It permits, for example, a transfer, or incurrence of an obligation, by a series in favor of another series of the same organization to be subject to voidable transaction analysis.

**Medium Neutrality**

* In order to accommodate electronic commerce and electronic storage of data, references in the Act to a “writing” have been replaced with “record,” and related changes made.

**Official Comments**

* Comments have been inserted explaining the provisions added by the amendments.
* The original comments and Prefatory Note have been supplemented and otherwise refreshed.

**New Official Comments**

* Future creditors not prejudiced by transferring the assets of a growing business into a limited liability organization if no financial distress existing or anticipated
* Conversely, future creditors may be prejudiced if, anticipating financial distress for its corporate business, the debtor converted shares in the corporation to interests in a limited liability company
* Avoidance of an obligation means subordination in favor of the creditor

**Amendments Rejected**

* Special rules for Ponzi schemes
* Special protections for charitable transfers
  + Note Minnesota revisions
* Change to statute of limitation
* Public policy exception on choice of law
* Punitive damages
* Recovery of legal fees
* Exemptions for derivative transactions similar to Bankruptcy Code § 546(e), (f) and (g)

**Transition**

* No uniform effective date
* Legislative note
  + The enacting bill should state that the amendments apply to transfers made and obligations incurred on or after the chosen effective date.

**Citations**

1. *In re Petters Co.,* 494 B.R. 413 (Bankr. D. Minn. 2013)
2. *In re Petters Co.,* 495 B.R. 887 (Bankr. D. Minn. 2013)
3. *In re Petters Co.,* 499 B.R. 342 (Bankr. D. Minn. 2013)
4. *First Bank v. First United Funding, LLC*822 N.W. 2d 306, 309, n.1 (Minn. Ct. App. 2012)
5. *Finn v. Alliant Bank*, 19HA-CV-11-2212, at \*19 (Minn. Dist. Ct. Mar. 19, 2013)
6. *Finn v. Alliance Bank,* 838 N.W.2d 585, 594-95 (Minn. Ct. App. 2013)
7. *Patrick Finn & Lighthouse Mgmt. Group, Inc. v. Peoples Bank of Wis*., 2012 U.S. Dist. LEXIS 130863 at \*64-66 (W.D. Wis. Aug. 22, 2012)
8. *Patrick Finn v. Western Security Bank*, Court File No. 11-42-BLG-RFC, at \*1 (D. Mont. Oct. 11, 2012)

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