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Code to Code

By Steven J. Boyajian

Reconsidering the Uniformity of Uniform Fraudulent Transfer Act

Steven J. Boyajian
Robinson & Cole LLP
Providence, R.I.

Steve Boyajian is an associate in the Providence, R.I., office of Robinson & Cole LLP.

The Drafting Committee on amendments to the Uniform Fraudulent Transfer Act (UFTA)[1] is considering amendments that would harmonize conflicting interpretations concerning pleading standards, burdens and presumptions in actions to avoid actually or constructively fraudulent transfers and obligations. The UFTA has been adopted in 43 states, Washington, D.C., and the U.S. Virgin Islands, and has not been significantly amended in the 30 years since it was drafted.[2] Despite the UFTA's admonition that it "shall be applied and construed to … make uniform the law with respect to the subject of [the UFTA] among states enacting it," portions of the UFTA have been subject to conflicting interpretations by courts nationwide.[3] As the primary vehicle for the avoidance of fraudulent transfers and obligations outside of the two-year limitations period of 11 U.S.C. § 548, conflicting interpretations of the UFTA have substantial practical significance to the litigation of fraudulent transfer claims in bankruptcy.

Amendments being considered by the Drafting Committee propose to resolve the conflicting judicial interpretations of the following issues: (1) the effect of § 2's presumption of insolvency if a debtor was generally not paying its debts as they become due; (2) the standard of pleading and proof applicable to a claim that a transfer was made or obligation incurred "with actual intent to hinder, delay, or defraud any creditor"; and (3) the allocation of burdens with respect to the elements of a claim to avoid a constructively fraudulent transfer or obligation.[4] The Drafting Committee's work is not complete, so it is not possible to determine what, if any, of the proposed amendments that it will adopt, and whether any amendments become law is completely dependent on the actions of state legislatures. The fact that the Drafting Committee is discussing amendments that address inconsistencies in judicial interpretation of the UFTA highlights those areas in which the application of the UFTA has been less than uniform.

The Presumption of Insolvency under § 2 of the UFTA

The existing § 2(a) of the UFTA adopts a balance-sheet standard of insolvency whereby a "debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." As drafted, the UFTA imposes a presumption of balance sheet insolvency against a defendant/transferee if a plaintiff can demonstrate that a "debtor ... is generally not paying his debts as they become due."[5] According to the official commentary, this presumption was intended to allocate the burden of proving the "nonexistence of insolvency" by preponderance to a defendant/transferee upon a plaintiff's demonstration of the debtor's equitable insolvency.[6] The existing official commentary indicates that the presumption of balance-sheet insolvency was "established in recognition of the difficulties typically imposed on a creditor" who might have limited access to a debtor's financial data.[7]

The allocation of the burden of persuasion to a defendant/transferee was seen as a rejection of the so-called "bursting bubble" theory of presumptions whereby "a presumption vanishes upon the introduction of evidence [that] would support a finding

1 The current version of the UFTA is available at www.uniformlaws.org/shared/docs/fraudulent%20transfer/ufta_final_1984.pdf.
2 The UFTA has not been adopted in Alaska, Kentucky, Louisiana, Maryland, New York, South Carolina, Virginia or Puerto Rico.
3 UFTA § 11.
4 Redlined versions, as of April 2013 and October 2013, illustrating the potential amendments to the UFTA and the Official Comments thereto are available at www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013Apr_AUFTA_MtgDraft.pdf and www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, respectively.
5 UFTA § 2(b).
6 UFTA § 2, cmt. 2.
7 UFTA § 2, cmt. 2.

of the nonexistence of the presumed fact."[8] Notwithstanding the expressed intention of § 2(b)'s insolvency presumption, some courts have interpreted § 2(b) as creating a bursting-bubble presumption, which does not affect the ultimate burden of persuasion with respect to insolvency.[9] Other courts have accepted the shifting burden of persuasion backed by the official commentary to UFTA § 2.[10]

The tentative amendments to § 2(b) would explicitly "impose … on the party against whom the presumption [of balance sheet insolvency] is directed the burden of proving that the nonexistence of insolvency is more probable than its existence."[11] While this amendment would resolve one point of judicial disagreement concerning the UFTA, it would codify a presumption that does not exist in the analogous provision of the Bankruptcy Code. The justification for § 2(b)'s insolvency presumption might be less apt in a bankruptcy context where trustees, debtors in possession and committees may have more extensive access to a debtor's financial information than transferees/defendants.

Standards of Pleading and Proof Applicable to Actions to Recover Actually Fraudulent Transfers

Section 4(a)(1) of the UFTA presently authorizes the avoidance of a transfer or obligation made or incurred "[w]ith actual intent to hinder, delay, or defraud any creditor of the debtor." Given the allusion to fraud in the statute, a number of decisions have imposed upon plaintiffs pleading requirements and standards of proof analogous to those applicable to common law fraud. In particular, some courts have held that pleadings in actions to recover actually fraudulent transfers must satisfy the particularity requirements of Fed. R. Civ. P. 9(b). Furthermore, some courts have imposed upon plaintiffs a clear and convincing standard of proof. The Drafting Committee is discussing an amendment to § 4, and the official commentary thereto should end the conflation of claims to recover actually fraudulent transfers and claims for common law fraud.

Pleading Standards

Courts considering whether complaints to avoid actually fraudulent transfers must comply with the particularity requirement of Fed. R. Civ. P. 9(b) have reached differing conclusions.[12] Neither § 4 of the UFTA nor the existing official commentary offer any guidance with respect to the issue. Courts finding Fed. R. Civ. P. 9(b) applicable to claims under UFTA § 4(a)(1) generally reason that the success of the claim depends on the demonstration of fraudulent conduct; therefore, the complaint alleges fraud and falls within the ambit of Fed. R. Civ. P. 9(b).[13] On the other hand, courts finding Fed. R. Civ. P. 9(b) inapplicable note that such a claim does not allege fraud against the defendant/transferee.[14]

> **The Drafting Committee's proposed amendments to the UFTA would result in an explicit rejection of varying standards, burdens and presumptions that are employed by courts in fraudulent transfer actions.**

The amended official commentary provides that "a procedural rule that imposes extraordinary pleading requirements on a claim of 'fraud,' without further gloss, should not be applied to a claim under § 4(a)(1)."[15] The Drafting Committee's proposed commentary provides three cogent reasons for eschewing the particularity requirements of Fed. R. Civ. P. 9(b). A fraudulent transfer action against a defendant/transferee is (1) unlikely to employed as a "strike suit" and (2) unlikely to be used a means to "discover unknown wrongs," and (3) "the elements of the claim [under UFTA § 4(a)(1)] do not require the defendant to have committed even an arguable wrong," and therefore do not pose the reputational threat attendant to fraud claims generally.[16] While amendments to the UFTA's official commentary might be an insufficient basis for courts to depart from existing precedent, the potential commentary amendments provide a reasoned basis for the conceptual distinction between fraudulent transfer and fraud claims.

Standard of Proof

Similar judicial disagreement has developed concerning whether a plaintiff seeking to recover an actually fraudulent transfer must prove the elements of a claim by clear and convincing evidence or by a preponderance of evidence. Courts requiring plaintiffs to satisfy the more-stringent standard tend to rely on precedent predating the UFTA, which adopted a clear and convincing standard based on an analogy between fraudulent transfers and common law fraud.[17] Despite § 4(a)(1)'s allusion to fraud and those cases adopting a clear and convincing standard, some courts have employed a pre-

8 UFTA § 2, cmt. 2 (quoting Fed. R. Evid. P. 301 advisory committee's note).

9 *See, e.g., Statutory Comm. of Unsecured Creditors v. Motorola Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 342-43 (Bankr. S.D.N.Y. 2007) (accepting bursting-bubble theory of D.C. Code § 28-3102's insolvency presumption); *Prairie Lakes Health Care System v. Wookey*, 583 N.W.2d 405, 414 n.6 (S.D. 1998) (stating that "[a]lthough the UFTA comments may suggest a more sound approach on how a presumption is overcome, our Legislature did not enact the UFTA comments, so we view them as merely [an] advisory").

10 *See Asarco LLC v. Ams. Mining Corp.*, 396 B.R. 278, 403-04 (S.D. Tex. 2008) (holding, under New Jersey and Delaware law, that defendant/transferee bore burden of demonstrating debtor's balance sheet solvency by preponderance of evidence in light of plaintiff's demonstration of debtor's equitable insolvency); *The 1992 Republican-Senate House Dinner Comm. v. Carolina's Pride Seafood Inc.*, 858 F. Supp. 243, 249-50 (D.D.C. 1994), *vacated after settlement*, 158 F.R.D. 223 (D.D.C. 1994) (interpreting Cal. Civ. Code § 3439.02(c) and reaching same conclusion).

11 Proposed UFTA § 2(b), *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, p.15. Indiana has already codified the precise language being considered by the Drafting Committee. *See* Ind. Code § 32-18-2-12(d).

12 *See Kranz v. Koenig*, 240 F.R.D. 453, 455-56 (D. Minn. 2007) (compiling cases).

13 *See Thimbler Inc. v. Unique Solutions Design Ltd.*, No. 5:12-cv-695-BR, 2013 U.S. Dist. LEXIS 129912, at *21-22 (E.D.N.C. Sept. 11, 2013); *Kranz*, 240 F.R.D. at 455-56 (holding that Fed. R. Civ. P. 9(b) applied to claim to avoid actually fraudulent transfer); *Van-American Ins. Co. v. Schiappa*, 191 F.R.D. 537, 543 (S.D. Ohio 2000) (same); *Feldman v. Chase Home Fin. (In re Image Masters Inc.)*, 421 B.R. 164, 183 (Bankr. E.D. Pa. 2009) (same).

14 *See, e.g., Taylor v. Cmty. Bankers Secs. LLC*, H-12-02088, 2013 U.S. Dist. LEXIS 86485, at *24-25 (S.D. Tex. June 20, 2013) (stating that "[t]he court thus sees no reason why [Fed. R. Civ. P.] 9(b), which prescribes a strict standard to prevent unfounded accusations against the defendant, should apply to fraudulent transfer cases in which the transferee's conduct is not alleged to be fraudulent"); *Janvey v. Alguire*, 846 F. Supp. 2d 662, 676 n.14 (N.D. Tex. 2011) (stating that "UFTA claims do not require any showing of scienter on the transferees/defendants' part").

15 *See* National Conference of Commissioners on Uniform State Laws, October 2013 Interim Draft, *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, p. 30.

16 *Id.*

17 *See Mann v. Hanil Bank*, 920 F. Supp. 944, 950 (E.D. Wis. 1996) (applying clear and convincing standard based on string of precedent originating with 1969 common law fraud claim); *Taunt v. Agrawal (In re Piccinini)*, 439 B.R. 100, 106 (Bankr. E.D. Mich. 2010) (citing *Al-Naimi v. Foodland Distributors Inc.*, 2009 Mich. App. LEXIS 1246 at *4 (Mich. App. 2009), which relied on authority considering whether fraud had been established to justify piercing a corporate veil); *Dahar v. Jackson (In re Jackson)*, 318 B.R. 5, 12-13 (Bankr. D.N.H. 2004) (adopting clear and convincing standard by relying on pre-UFTA precedent which, in turn, relied on precedents concerning common law fraud).

ponderance-of-the-evidence standard with respect to claims to avoid actually fraudulent transfers and obligations.[18]

An amendment under discussion by the Drafting Committee (UFTA § 4(c)) would explicitly provide that a "party making a claim based on subsection (a) [including actually fraudulent transfers] has the burden of proving the elements of the claim by a preponderance of the evidence."[19] The Drafting Committee's proposed commentary concerning this amendment explains that prior analogies of actually fraudulent transfers to common law fraud are misguided, as "§ 4(a)(1) applies to a transaction that 'hinders' or 'delays' a creditor even if it does not 'defraud.'"[20] The most recent proposed commentary explains that

> [t]he phrase "hinder, delay, or defraud" is a term of art whose words do not have their dictionary meanings. For example, every grant of a security interest "hinders" the debtor's unsecured creditors in the dictionary sense of that word. Yet it would be absurd to suggest that every grant of a security interest contravenes § 4(a)(1)…. Whether a transaction is captured by § 4(a)(1) ultimately depends upon whether the transaction unacceptably contravenes the norms of creditor's rights.[21]

In light of this proposed explanation, the Drafting Committee appears to be suggesting a near-complete disentanglement of actually fraudulent transfers from common law fraud.

Abolition of Shifting Burdens of Persuasion in Avoidance of Constructively Fraudulent Transfers and Obligations

Proposed §§ 4(c) and 5(c) would abolish nonstatutory presumptions and shifting burdens regularly employed in actions to avoid constructively fraudulent transfers and obligations. Many courts have adopted nonstatutory presumptions and burdens that require a defendant/transferee to negate one or more of the elements of a claim to avoid a constructively fraudulent transfer or obligation. For example, upon a showing that a transferor was in debt, Pennsylvania's UFTA was previously interpreted to require a defendant/transferee to establish either that the debtor was solvent, or that the defendant/transferee gave reasonably equivalent value in exchange for the challenged transfer.[22] Defendant/transferees are commonly required to establish a debtor's solvency upon a showing that a transfer was made for less than the reasonably equivalent value.[23] Other courts require a defendant/transferee to demonstrate that it provided reasonably equivalent value in order to prevent avoidance of a transfer.[24]

The Drafting Committee's proposed insertion of §§ 4(c) and 5(c) would reject each of these presumption schemes and would allocate the burden of proof on each element of fraudulent transfer claims to plaintiffs by a preponderance of the evidence.[25] The proposed commentary indicates that proposed §§ 4(c) and 5(c) are intended to preserve statutorily allocated burdens of persuasion, maintain uniformity and prevent the perpetuation of obsolete principles that are embodied in the existing law.

Conclusion

The Drafting Committee's proposed amendments to the UFTA would result in an explicit rejection of varying standards, burdens and presumptions that are employed by courts in fraudulent transfer actions. If adopted, these proposed amendments would overrule volumes of pre-UFTA precedent that has resulted in the non-uniform application of an otherwise-uniform statute. Since the Drafting Committee's work is ongoing, it is difficult to predict what amendments, if any, will be adopted, and it is more difficult still to determine whether an amended UFTA will be enacted by state legislatures. However, the very fact that the Drafting Committee is undertaking this revision demonstrates the recognition of disparate approaches to UFTA litigation and the practical effect that those differing approaches may have on litigants' strategy and outcomes. abi

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18 *See Stillwater Nat'l Bank & Trust v. Kirtley (In re Solomon)*, 300 B.R. 57, 62-63 (Bankr. D. Okla. 2003); *Prairie Lakes Health Care System*, 583 N.W.2d at 411; *Gagan v. Gouyud*, 86 Cal. Rptr. 2d 733, 735 (Cal. Ct. App. 1999), *disapproved on other grounds in Mejia v. Reed*, 31 Cal. 4th 657, 661, 669, ftn. 2 (Cal. Aug. 14, 2003); *Morris v. Nance*, 888 P.2d 571, 576 (Ore. Ct. App. 1994).

19 *See* National Conference of Commissioners on Uniform State Laws, April 2013 Interim Draft, *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013Apr_AUFTA_MtgDraft.pdf, p. 22.

20 Proposed UFTA § 4, cmt. 10, *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, p. 30.

21 Proposed UFTA § 4, cmt. 8, *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013Apr_AUFTA_MtgDraft.pdf, pp.28-29, and www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, p. 27.

22 *See 718 Arch St. Assoc. Ltd. v. Blatstein (In re Blatstein; In re Main Inc.)*, 192 F.3d 88, 98 (3d Cir. 1999); *Walsh v. Gutshall (In re Walter)*, 261 B.R. 139, 143 (Bankr. W.D. Pa. 2001); *Krasny v. Nam (In re Nam)*, 257 B.R. 749, 767 (Bankr. E.D. Pa. 2000); *but see Liebersohn v. Campus Crusade for Christ Inc. (In re C.F. Foods LP)*, 280 B.R. 103, 115 (Bankr. E.D. Pa. 2002).

23 *See, e.g., Ohio Corrugating Co. v. Sec. Pac. Bus. Credit Inc. (In re Ohio Corrugating Co.)*, 70 B.R. 920, 927-28 (Bankr. N.D. Ohio 1987); *Benson v. Richardson*, 537 N.W.2d 748, 756-57 (Iowa 1995).

24 *See, e.g., Berland v. Mussa (In re Mussa)*, 215 B.R. 158, 170-71 (Bankr. N.D. Ill. 1997).

25 Proposed UFTA §§ 4(c) and 5(c), *available at* www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013Apr_AUFTA_MtgDraft.pdf, pp. 22-30, and www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_BLACKLINED.pdf, pp. 21 and 31.