



WINTER IS COMING.

The New UFTA and Ethical Quagmires
in Pre-Bankruptcy Transfers

Panel

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The 2014 Amendments to the Uniform Fraudulent Transfer Act

Title of the Act

- o The title of the Act will be changed to the “Uniform Voidable Transactions Act”
- o The change is consistent with
 - o substitution of the word “voidable” for the word “fraudulent” throughout the text of the Act, and
 - o the Act historically covering the incurrence of obligations in addition to transfers of property
- o The title has been changed before
 - o “Conveyance” in UFCA to “Transfer” in UFTA

“Fraudulent” vs. “Voidable”

- As originally written, the Act 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.

Actual/Constructive Fraud

- UVTA § 4(a)(1) (actual 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
 - No proof of common law fraud required
- UVTA § 4(a)(2) (constructive fraud).

Terminology

◦ Comments

- The changes in terminology do not affect other law
- Debtor's counsel still has a duty to comprehensively advise his client on pre-filing transfers.
- 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

Choice of Law

- Apply the fraudulent transfer law of the location of the debtor at time of the transfer or the inurrence 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

Choice of Law cont.

- International Management Associates, LLC v. Champagne (In re International Management Associates, LLC), 495 B.R. 96 (Bankr. N.D. Ga. 2013) (Bonapfel, J).

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 is on the party asserting that a transaction is voidable, and the standard of proof is the preponderance of the evidence.

Determining “Insolvency”

- o UFTA § 2(b) currently provides that insolvency is presumed if the debtor is not generally paying its debts when due
 - o No similar presumption in the Bankruptcy Code
 - o The amendments will move into the statute two points previously only in the comments:
 - o A debt that is in bona fide dispute does not count as debt
 - o If the presumption is triggered, its effect is to shift the burden of persuasion on solvency to the transferee

Determining “Insolvency” for Partnerships

- o 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
- o The amendments delete the special definition
- o Will be a variation from Bankruptcy Code

Defenses

- o As originally written, the Act created a complete defense to an actual fraudulent transfer action if the transferee or obligee took in good faith and for a reasonably equivalent value
 - o No equivalent defense in the Bankruptcy Code
- o The amendments add that the reasonably equivalent value must be given to the debtor
 - o This amendment would produce a different outcome than in *In re Chapman Lumber Co.*, 2007 WL 2316528 (Bankr. N.D. Iowa 2007)

Defenses cont.

- o 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
- o 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

Defenses cont.

- As UFTA created a defense to a fraudulent transfer, other than an actual 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:
 - "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

- Like the comments to the Uniform Commercial Code, reference to the official comments of the Voidable Transaction Act is essential to understanding.
- Comments are not in the OCGA but are available on the Uniform Law Commission’s website.
- Comments have been inserted explaining the provisions added by the amendments.
- The original comments and Prefatory Note have been supplemented and otherwise refreshed.

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.

The End of Jake's Part

Mining the Comments; Some Examples

Writing v. Record

- Ex: Oral agmt. that's effective between parties on Thu; confirming email by obligor drafted on Fri; stuck in outgoing email until Mon.
- Treatment: Email is a "record" under §6; doesn't count until delivered; however, it's irrelevant for when the obligation was incurred under §6 because the obligation was incurred on Thu when it became effective between the parties.

Meaning of “Transfer”

- Ex: Company grants another company a perpetual, exclusive, royalty free, non-cancellable license to install its only software product.
- Treatment: For the avoidance of any doubt, “transfer” now includes, explicitly, a “license.”
- See also *In re NextWave Pers. Comms. Inc.*, 200 F.3d 43 (2d Cir. 1999) (fascinating case involving voidability of licensee obligations to FCC).

Meaning of “Asset”

- Ex: Under intercreditor agreement, senior lender is subrogated to junior lender for junior’s rights, claims, etc. against debtor, including its right to vote on plan.
- Treatment: Senior lender’s subrogation claim = asset for purposes of determining senior’s solvency.
- Cocktail Question: What is the value, if any, of the right to vote the junior’s claim in a 3 party dispute?
- See *In re Avondale Gateway Center Entitlement, LLC*, 2011 U.S. Dist LEXIS 41450 (D. Ariz. 2011).

“Fair Valuation” of Debts

- Amendments clarify that “fair valuation” applies to assets and liabilities, not just assets.
- Ex: Assume that FASB standards require a contingent guaranty to be discounted to reflect low likelihood of direct obligor defaulting.
- Treatment: Under the Act, otherwise required accounting discounts for liabilities are ignored.
- Face value is the presumed “fair valuation.”

Nonpayment; Bona Fide Disputes

- Ex: Bank sues debtor in a traditional suit on a note secured by real estate; sole “defense” is that bank should chase collateral first (i.e. it should mitigate).
- Treatment: Insolvency presumption likely still triggered unless defense = bona fide dispute.
- Issue: When is there a bona fide dispute?
- *In re Marketing & Creative Solutions, Inc.*, 338 B.R. 300, 305 (B.A.P. 6th Cir. 2006) (when there’s a legitimate factual or legal basis for not paying)
- Conforms Act’s *text* to 11 U.S.C. § 303(h)(1).

Don't Forget §4(b)(11)

- o Ex: Lender forecloses on company's assets; transfers them to company's affiliate on same loan terms as before; company reopens.
- o Treatment: An indicia of "actual intent."
- o Nothing new here; just expanded commentary.
- o Is §4(b)(11) the Act's absolute priority rule? *See Northern Pacific Co. v. Boyd*, 228 U.S. 482.

Hinder, Delay, Defraud

- o Drafters are vain about this "primordial" phrase.
- o Out with "actual" v. "constructive" fraud
- o Hair-trigger emphasis on contravening rights
- o Ex: Solvent debtor transfers assets to wholly-owned corporation to get a receivership.
- o Ex: Owners try to convert corp to an LLC.
- o Ex: Debtor overcollateralizes debt.
- o Treatment: Potentially (likely) voidable.

But State Law Said I Could Do It

- Ex 1: Debtor resides in State X which adopted the Act; Debtor employs a creditor-thwarting asset protection device under law of State X.
- Ex 2: Same facts, but Debtor resides in State Y which also adopted the Act; State Y doesn't recognize that asset protection device.
- Treatment: Law of residence applies; absent other facts, not voidable in State X as its other laws intervene; voidable in State Y.

What about Bulk Transfers?

- Example: Wisconsin debtor with its HQ and CEO sitting in Wisconsin conducts a bulk sale of its assets located in Georgia.
- Treatment: Although expanded commentary clarifies that the Act doesn't preempt bulk sale statutes, and Georgia still has a bulk sale statute, it's of no avail, as Wisconsin law controls and Wisconsin repealed its bulk sale statute in 2010.

Standards of Proof

- Ex: Creditor sues debtor for an “actual intent”-transfer; debtor’s counsel pulls out his old “clear and convincing” common law fraud form.
- Treatment: Debtor needs to update his forms. The clear and convincing standard might apply in common law fraud cases, but preponderance of the evidence now applies under the Act.

Standards of Pleading

- Ex: Creditor sues debtor for “actual intent” transfer; debtor raises 8(a) particularity defense.
- Treatment: Debtor’s defense fails for the same reasons that his standard of proof argument failed--the elements for relief under the Act are very different than those for common law fraud.
- Rationale: Act claims are not susceptible to abuse; rarely involve unknown wrongs, etc.

“Avoidance” as a Term of Art

- Ex: Debtor transfers \$100 of property to his mother; owes Creditor 1 \$80 and Creditor 2 \$50.
- Treatment: In a suit by Creditor 1, “avoidance” of the transfer leaves mom w/ \$20 surplus. Debtor can’t recover the \$20; nor can Creditor 2 mine Creditor 1’s efforts and recover surplus.
- See §4(a)(1) (“avoidance” only to the “extent necessary to satisfy the creditor’s claim”).
- Not new; just clarifying commentary.

Transferees and Defenses

- Ex: Voidable transfer from X to Y and then Y transfers to Z. X has a creditor, C-1.
- Treatment: C-1 can get a money judgment from Y under §8(b). However, C-1 can’t recover from Z, as Z would be protected under §8(b)(1)(ii)(A) if Z took for value; but the Y to Z transfer might be independently voidable (even by C-1 per its rights under the Act).
- Apply choice of law to X and Y separately.

Choice of Law

- Ex: 5 yrs ago, GA father guarantees son's debt gratuitously; father moves from GA (has adopted Act) to State Y (hasn't adopted Act); son defaulted this year; lender sues father; father files Ch. 11 in State Y, which has a 6 year statute; father challenges guaranty under the Act, relying (i) on State Y's 6 yr statute and (ii) notion that obligation was incurred when guaranty triggered (not when it was signed)

Choice of Law (cont.)

- Treatment: Father loses because GA law applies.
- First, the obligation was incurred when the guaranty was *signed*, not when it was triggered.
- Second, the guaranty obligation was incurred in GA, so GA law and its 4 year statute applies (not State Y's law and its 6 year statute).
- It's more than 5 years old, so the *right* to maintain the suit is barred; not just the remedy.

Choice of Law: No Funny Business

- Ex: GA company's 100% owner names her husband as CEO; he sets up the Company HQ in DE when DE adopts a state of the art creditor thwarting device; however, the shareholder-wife is really in charge; the CEO effectuates an asset transfer from DE.
- Treatment: GA law applies, as the "place of business" is really GA; husband is just a straw man residing at an artificial HQ in DE.

"Series Organizations"—Huh?

- Georgia law doesn't recognize "series organizations," so who cares?
- The Act warns that regardless of whether the adopting state recognizes series organizations, it should adopt the new series organization rules.
- That is because a debtor might have made a series-organization-related transfer in a state that *does* recognize them (e.g. DE), thus triggering the location-based choice of law rules.

Layering in Ethics

- From an ethics standpoint it is important for attorneys to be very careful not to assist in fraudulent transfers or other types of inappropriate conduct by their clients.

The Line Between Legitimate and Fraudulent

- Remedies available under UFTA and new UFTA include a “catch-all” provision that allows for “any other relief the circumstances may require.”
- Need evidence supporting the conclusion that the attorney knew that his or her client intended to hinder, delay or defraud creditors.

A Civil Action?

- Recent cases have rejected viability of a claim for civil conspiracy to commit a fraudulent transfer
- Other courts have expressed a willingness to extend the prohibition against claims for aiding and abetting fraudulent transfers to claims against non-transferees for conspiracy to commit a fraudulent transfer.

Privilege

- Participation by an attorney in transactions to hinder, delay or defraud creditors may also result in waiver of the attorney client privilege and the attorney work product doctrine.

Violation of Rules of Professional Conduct

- Rule 1.2(d): cannot counsel a client to engage or assist a client in conduct that the lawyer knows is criminal or fraudulent.
- Lawyer may not continue to assist a client in conduct that the lawyer initially believes to be lawful but later discovers is criminal or fraudulent.
 - Attorney must withdraw

Duty of Competency

- Asset protection and pre-bankruptcy planning issues involve great deal of specialized knowledge and training

Parking Funds

- Advising a client to pay money into the attorney's trust account in order to shield assets from the client's creditors is actionable.
- Whether the deposit made to the attorney constitutes a reasonable retainer versus a transparent plan to simply hide assets is a matter for the fact finder to determine.

Bankruptcy Crimes

- Attorney's participation in asset protection or pre-bankruptcy planning with knowledge that a specific transaction or transactions are unlawful or fraudulent may expose the attorney to criminal liability.
 - 28 USC §§ 152, 157, 1519.
- Various statutes give rise to potential criminal liability in connection with the hiding of assets

Ethical Pre-Bankruptcy Planning

- o Objectives:
 - o (1) Avoid need for bankruptcy relief altogether
 - o (2) Minimize what becomes property of the estate
 - o (3) Maximize exempt property
 - o (4) Select appropriate type of bankruptcy
 - o (5) Analyze timing considerations
 - o (6) Preserve the discharge
 - o (7) Plan for clawback attempts
 - o (8) Avoid bankruptcy crimes

Bottom Line

- o It is incumbent on lawyers to help their clients understand:
 - o Problems and risks inherent in any transfer
 - o Extensive disclosure entailed in voluntary and involuntary bankruptcy cases
 - o Potential consequences of a court finding that actions were improper, including loss of a bankruptcy discharge and possible criminal conviction
- o Instruct client on attorney disclosure obligations of Rule 3.3 and the crime-fraud exception to the attorney-client privilege.

Dude, Where's My Commissions?

Facts:

- o Incorporated real estate company owes commissions to one of its brokers.
 - o So, they fire her.
- o The Court awards her \$150,000.
 - o So, the company dissolves and two lawyers help the company convert to an LLC
- o Separate lawsuit against attorneys by the company derivatively

What does a divorce in Georgia have in common with a hurricane in Florida?

Facts:

- o Transfers structured in uncontested divorce decrees
- o Couple hopelessly insolvent (and unhappy) and husband's creditors coming fast.
- o Set up a quick divorce putting property in the name of the wife

Angry Birds Lenders

o Facts:

- o Two affiliates with a common 100% owner
- o Single lender; two separate loans
- o Lender worried about A1's loan
- o Demands refinance of A2's loan
- o Large % of refinance proceeds applied to A1's loan; proceeds never distributed directly to A2

Final Note

- o **The attorney should establish extensive due diligence procedures in connection with the screening of clients for asset protection planning.**
- o Financial statements, current business matters, pending or threatened lawsuits, marital status, anticipated changes in client's activities, etc. must all be studied.