REPORT ON LEGISLATION BY THE
COMMITTEE ON COMMERCIAL AND UNIFORM STATE LAWS AND
COMMITTEE ON BANKRUPTCY AND CORPORATE REORGANIZATION

A.1853                      M. of A. Weinstein
S.6180                      Sen. Bonacic

AN ACT to amend the debtor and creditor law, in relation to enacting the uniform voidable transactions act; and to repeal provisions of such law relating to fraudulent conveyances.

The Uniform Voidable Transactions Act

THIS BILL IS APPROVED

The New York City Bar Association’s Committee on Commercial and Uniform State Laws and Committee on Bankruptcy and Corporate Reorganization approve and support the bill. The bill would enact the Uniform Voidable Transactions Act (the “UVTA”), promulgated by the Uniform Law Commissioners in 2014, replacing the current provisions in Article 10 (§§ 270-281) of the Debtor and Creditor Law, which are based on the Uniform Fraudulent Conveyance Act (the “UFCA”)—which was promulgated by the Uniform Law Commissioners in 1918 and enacted in New York in 1925.

DEVELOPMENT OF UNIFORM LAWS ON FRAUDULENT TRANSFERS

The Commissioners promulgated the Uniform Fraudulent Transfer Act (“UFTA”) in 1984 to modernize and rationalize the 1918 UFCA. The UFTA incorporated many of the features of the fraudulent transfer provisions of the federal bankruptcy reform act of 1978. The 1984 UFTA became the law in forty-four states, the District of Columbia, and the U.S. Virgin Islands.

In July 2014, the Uniform Law Commissioners approved modest improvements to the UFTA and renamed it the Uniform Voidable Transactions Act,¹ to reflect that the act covers the incurrence of obligations, as well as transfers, and that so-called “fraudulent transfers” do not require proof of the elements of common law fraud. The UVTA provides remedies available to creditors injured by what traditionally have been referred to as “intentional” or “constructive” fraudulent conveyances or transfers—property transferred or obligations incurred (a) by a debtor with actual intent to hinder, delay or defraud its creditors or (b) for less than fair consideration by an insolvent or undercapitalized debtor.

¹ The official UVTA text with comments is available at:
REASONS FOR THIS BILL

New York Fraudulent Conveyance Law is Archaic. Article 10 of the Debtor and Creditor Law has not been updated significantly in 90 years and is based on a “model” statute promulgated in 1918. Only New York and Maryland retain the UFCA. The proposed legislation would modernize the New York statute to reflect 100 years of developments in commercial law, legal terminology and practice and resolve many open questions under the UFCA.

New York Fraudulent Conveyance Law is Inconsistent with Federal Law and the Law in Most States. The existing New York statute differs in important respects from the law of the 44 states that have enacted the UFTA or the UVTA, on which this bill is based, and from the fraudulent transfer provisions of the U.S. Bankruptcy Code. This leads to confusion and disparate results depending on what law is applied. These differences also fuel costly litigation over choice-of-law issues. Enactment of this bill should ameliorate all of these issues.

New York Would Benefit From a Modern Statute Consistent with other Law. New York is the country’s financial center and a leader in the development of commercial law. It is in the general public interest and the interest of commerce for New York (i) to have efficient and fair remedies for creditors who are victims of voidable transactions (ii) while also protecting the justified interests of innocent and good faith recipients or beneficiaries of challenged transactions from unwarranted or inappropriate avoidance claims. It is also in the public interest to minimize litigation over choice of law by making New York voidable transactions law consistent with the law applied in the majority of other states and bankruptcy courts and by having clear New York choice of law rules that produce predictable results. It is a serious embarrassment for New York to retain an archaic statute that adds significantly to cost and uncertainty in transactions with a tie to New York. Enactment of the UVTA would further the interests of New York as a preeminent commercial jurisdiction.

Updating the Law Would Benefit Present and Potential Future Creditors. Every present creditor or potential future creditor has an interest in an efficient and certain remedy in the event that a person or entity (a “debtor”) attempts to hide its assets from creditors, or otherwise acts in a way that prejudices creditors. The class of present and potential creditors of a debtor engaging in improper transactions with its assets, who would benefit from making the law more efficient and certain includes the following:

- State and local taxing authorities, seeking to collect delinquent taxes;
- Present and potential involuntary tort creditors of a debtor;
- Present and potential clients of a professional debtor with malpractice claims;
- The non-moneyed spouse in a divorce action;
- Minors who are the beneficiaries of child support orders;
• Victims of a Ponzi scheme, where avoidance law is often the primary source of recovery;

• Lenders and merchants that extend unsecured credit.

In addition, recipients of transfers who may be subject to “claw back” avoidance litigation would benefit from the new statute’s clarification of numerous substantive and procedural matters and its reduction of the uniquely long six-year “fraud” statute of limitations. The new statute also would eliminate the disincentive to organize a professional firm as a New York partnership caused by New York’s unique rules allowing “claw back” of compensation for services paid to partners after insolvency, which is unduly harsh and does not apply to other types of business organizations.

There Has Been No Stated Opposition to a Modern, Efficient Fraudulent Transfer Statute. Enactment of the UVTA would not impair any important New York state policy expressed in the existing law. The reporter and chair of the drafting committee of the Uniform Law Commission are not aware of any organized opposition to the UVTA. The UVTA has already been enacted by nine states, and bills to enact it are pending in six other states as of this date, with no opposition from consumer, finance or other interest groups.

SUMMARY OF SIGNIFICANT PROPOSED CHANGES TO NEW YORK LAW

Choice of Law

The UVTA makes the law of the place where the debtor/transferor is located when the transfer is made the law applicable to the voidability of the transfer (UVTA § 10). An organization is located at its place of business or, if it has more than one place of business, at its chief executive office. Currently, New York applies a common law “factors” choice of law analysis to fraudulent conveyance claims. This increases the cost of, and produces unpredictable outcomes in litigation and makes it difficult for parties to assess avoidance risk prior to engaging in a transaction.

Statute of Repose

Section 9 of the UVTA contains a four-year statute of repose—i.e., four years from the date the transfer was made or the obligation was incurred—for claims other than an “insider preference” (discussed below). Section 9(a) also includes a “discovery rule” for claims to void transfers made with actual intent to hinder, delay or defraud, which are preserved until “not later than one year after the transfer or obligation” “was or could reasonably have been discovered.” UVTA § 9(a). New York now applies the six-year fraud statute of limitations to all avoidance claims, the longest period

2 California, Georgia, Idaho, Iowa, Kentucky, Minnesota, New Mexico, North Carolina and North Dakota.
3 Indiana, Massachusetts, Michigan, New Jersey, Rhode Island and South Carolina.
4 For simplicity of discussion and ease of reading, this memorandum refers only to avoiding “transfers made” or “transactions”, although the statute applies equally to both avoiding transfers made and avoiding obligations incurred.
5 The rules for determining where a debtor is located under Section 10 of the UVTA are similar to those for determining where a debtor is located for the purposes of perfecting security interests under Article 9 of the Uniform Commercial Code.
in the country during which a transfer may be challenged. See CPLR 213. Shortening the period to four years, while retaining a discovery rule, fairly balances other changes that benefit parties asserting claims and will eliminate a major incentive for “choice of law” litigation.

**Clarification of Insider Preferences**

Current New York law allows repayment of a debt to an insider to be recovered on the vague grounds that it was not made in “good faith,” arguably allowing “claw back” even if the Debtor was not in insolvent when it made the payment. The UVTA renders voidable insider debt repayments by an insolvent debtor if the insider had reasonable cause to believe the debtor was insolvent. UVTA § 5(b).

**Partnership Insolvency**

New York law currently permits “claw back” of compensation for services when applied to a large professional partnership, whose “partners” are akin to employees. No such rule applies to other business organizations. The draconian impact of New York law was illustrated in the recent decision in the bankruptcy of *Dewey & LeBoeuf*.

All transfers to the partners after the partnership insolvency were recoverable by the trustee in bankruptcy, with no right to offset the value of services provided the partnership after the transfers. Adoption of the UVTA would eliminate this disincentive to operating partnerships subject to New York law.

**Attorneys’ Fees**

New York currently is unique in awarding attorney’s fees where a transfer is avoided on a finding of actual intent to hinder, delay or defraud, but not where the transfer is avoided for constructive fraud. Removing the attorneys’ fee provision will remove the incentive to plead unnecessary fraudulent intent claims and also recognizes that avoidance claims are civil actions to which the American rule against shifting legal fees should apply.

**“Badges of Fraud” – Defendant in Litigation**

New York law is also unique in making all transfers by a defendant during pending litigation, if made without “fair consideration,” voidable as to the plaintiff in the litigation (but not other creditors) if the plaintiff obtains an unsatisfied judgment. Debtor and Creditor Law § 273-a. Under the uniform statute, a transfer by a defendant in a pending litigation is a “badge of fraud” that may be relied upon, along with other factors, by all injured creditors in evaluating whether actual intent to hinder, delay or defraud creditors can be inferred. UVTA § 4(b)(4).

**Good Faith as an Element of Fair Consideration**

New York law permits the avoidance of a transfer as constructively fraudulent if the plaintiff proves it was received in “bad faith” even if the debtor was given “equivalent value”, thereby encouraging claimants to put into issue the recipient’s knowledge at the time it received a transfer that did not injure creditors. Debtor and Creditor Law §§ 273-275 (elements); § 272 (definition).

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Under the UVTA and the Bankruptcy Code, the transferee’s intent is irrelevant to the question of whether a transfer is voidable. The transferee must prove its own “good faith” only when it asserts an affirmative defense to a transfer claimed voidable based on the transferor’s improper intent.

Measure of Fair Consideration in Security Transfers

Under current New York law, the test of fair value for a grant of a security interest is whether the debt being secured is “disproportionately small” as compared to the value of the collateral subject to the security interest. The UVTA abandons this test as unnecessary and inconsistent with the modern law of security interests that adequately protects the debtor’s interest in the residual value of any excess collateral granted a secured creditor.

Burden of Proof

The burden of proof for all claims and defenses under the UVTA is “preponderance of the evidence.” UVTA §§ 4(c), 5(c), 8(h). New York’s current law requires “clear and convincing” proof of the transferor’s intent to hinder, delay or defraud creditors. The UVTA rejects any analogy to common law fraud and its heightened standard of proof. UVTA § 4 cmt. 10.

Burdens and Presumptions; Insolvency Standard

Unlike current law, the UVTA specifies the elements of each claim and each defense and allocates the burden of proof on each element of the claim to the plaintiff (UVTA §§ 4(c), 5(c) while allocating the burden of proof of most elements of the affirmative defenses to the defendant (UVTA § 8(g)). These provisions will provide clarity to parties and courts.

Transferees

The UVTA clarifies the protections available to initial transferees and subsequent transferees of property transferred in a voidable transaction, including the credit available for any amounts paid for or expended to improve the property. Adoption of these rules in New York would enhance the protections to innocent parties that enter into transactions without knowledge of the impaired financial condition of the transferor from whom they receive their interest in the property transferred.

IMPACT ON OTHER AREAS OF NEW YORK LAW

Civil Procedure, Remedies, Pleading and Proof

As summarized above, the new legislation would change or clarify applicable choice of law rules, the available provisional and final remedies, and rules of pleading, presumptions and burden of persuasion.

Family Law

Avoidance claims can arise in the context of divorce and property settlements, where a spouse may have transferred property to frustrate equitable distribution rights. The UVTA also
clarifies the protections from claims of creditors of the transferring spouse available to an innocent spouse who has received property in connection with the dissolution of a marriage.

**Tax and Tort Claimants**

The UVTA provides the same protections for involuntary tort and tax creditors as it does for contractual creditors against the debtor’s improper transfers. This will aid involuntary creditors in collecting on their claims.

**Real Property and Personal Property Security Interests**

The UVTA protects a purchaser of real or personal property that is the subject of a foreclosure sale by establishing the finality of a transfer pursuant to a regularly conducted foreclosure sale. This does not apply to property retained by the secured creditor in a “strict foreclosure” where there is no market test of the property value. This protection for purchasers should improve the prices realized in foreclosure sales, to the benefit of both borrowers and their creditors.

**Criminal Law**

The proposed legislation proposes no changes to criminal law applicable to persons who commit frauds punishable under the Criminal Law.

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