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MEMORANDUM

To: Senate Committee on Judiciary II
From: General Statutes Commission
Re: SB 123 (Uniform Fraudulent Transfer Act)
Date: March 16, 2015

General Comments

This bill amends the Uniform Fraudulent Transfer Act, Article 3A of Chapter 39 of the General Statutes, which establishes the circumstances under which a transfer of property or incurrence of obligation by a debtor is voidable as to a creditor and sets forth the remedies of a creditor with respect to the transfer or obligation. The bill is based on the amendments to the Uniform Fraudulent Transfer Act that were approved in 2014 by the National Conference of Commissioners on Uniform State Laws to address several narrowly-defined issues. In general, the amendments:

- Change the name of the Uniform Fraudulent Transfer Act (the "Act") to the "Uniform Voidable Transactions Act."
- Make stylistic changes that are not intended to change the meaning of the Act, such as consistently using the word "voidable" instead of "fraudulent" to denote a transfer or obligation for which the Act provides a remedy.
- Define the new terms "electronic," "organization," "record," and "sign." § 39-23.1.
- Delete the special definition of "insolvency" applicable to partnerships, thereby subjecting partnerships to the general definition of "insolvency" in the Act. § 39-23.2.
- Add uniform provisions allocating the burden of proof and defining the standard of proof with respect to claims and defenses under the Act. §§ 39-23.2(b), 39-23.4(c), 39-23.5(c), and 39-23.8(g) and (h).
- Replace references in the Act to a "writing" with "record" in order to accommodate modern technology. § 39-23.6(5).
- Refine several provisions relating to defenses available to a transferee or obligee. § 39-23.8.
- Add a choice of law provision for claims governed by the Act. § 39-23.9A.
- Respond to the emergence of the "series organization" as a significant form of business organization by providing that each "protected series" of a "series organization" is to be treated as a person for purposes of the Act. § 39-23.9B.
- Add a standard provision found in uniform acts that addresses the Act's relationship to the Electronic Signatures in Global and National Commerce Act (also known as "E-Sign"). § 39-23.11A.
- Make related conforming and technical amendments to other sections of the General Statutes.

Both the Business Law and Bankruptcy Law Sections of the North Carolina Bar Association have approved the amendments and support their passage.

Specific Comments

Section 1 retitles the Uniform Fraudulent Transfer Act (the "Act") as the "Uniform Voidable Transactions Act" because fraud never has been a necessary element of a claim under the Act and the Act has always applied to the incurrence of an obligation as well as the transfer of property. Section 1 also amends various sections of the Act and adds three new sections to the Act.

§ 39-23.1 is amended to make stylistic and conforming changes to the definitions, to add definitions of "electronic," "organization," "record," and "sign," and to expand the definition of “transfer” to add "license" as a mode of disposing of or parting with assets.

§ 39-23.2, which defines "insolvency" for purposes of the Act, is amended to:

- Clarify that the general definition of "insolvency" in subsection (a) requires a "fair valuation" of the debtor's debts as well as the debtor's assets.
- Clarify that the nonpayment of debts as the result of a bona fide dispute are not counted under subsection (b), which establishes a rebuttable presumption of insolvency from the fact of general nonpayment of debts as they become due.
- Provide that the presumption under subsection (b) imposes on the party against which the presumption is directed the burden of proving that the nonexistence of insolvency is more probable than its existence.
- Delete the special definition of "insolvency" for partnerships in subsection (c), thereby subjecting partnerships to the general definition of "insolvency" in subsection (a). Subsection (c), which counts the assets of a general partner as assets of the partnership for purposes of determining the partnership's insolvency, is deleted because (i) it is no longer the case that all general partners are liable for all debts of the partnership under some modern partnership statutes and (ii) there is not a good reason to credit a partnership with the net worth of its general partners when a non-partnership entity whose debts are guaranteed by contract receives no credit for the net worth of its guarantor.

§ 39-23.4, which defines the transfers and obligations that are voidable as to present or future creditors, is amended to make conforming and technical changes and to add subsection (c) stating that a creditor making a claim for relief under the section has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

§ 39-23.5, which defines the transfers and obligations that are voidable as to present creditors, is amended to make conforming and technical amendments and to add subsection (c) stating that a creditor making a claim for relief under the section has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

§ 39-23.6, which states when a transfer is made or an obligation is incurred for purposes of the Act, is amended to make a technical change and to change "writing" to "record" and "writing executed" to "record signed" to accommodate modern technology.

§ 39-23.7, which provides a nonexclusive list of remedies available to a creditor in an action for relief against a transfer or obligation under the Act, is amended to make technical changes and to substitute "if available under applicable law" for "in accordance with the procedure prescribed by Article 35 of Chapter 1 of the General Statutes." This change avoids the need to include a cross-reference to the specific statutes applicable to attachment and other provisional remedies because of the possibility of creating a litigation issue in the event that the cross-reference does not correctly identify the statutes applicable to provisional remedies that are in force when litigation ensues and the likelihood that the cross-reference may not be updated if the proper reference later changes.

§ 39-23.8, which provides defenses to an avoidance action and prescribes the measure of liability of a transferee or obligee under the Act, is amended to make formatting, stylistic, and clarifying changes and the following additional changes:

- Subsection (a) provides a defense to the transferee of a transfer made or the obligee of an obligation incurred by a debtor with intent to hinder, delay or defraud any creditor of the debtor if the transferee or obligee "took in good faith" and "for a reasonably equivalent value." The subsection is amended to provide that the reasonably equivalent value must be given to the debtor in order for the transferee or obligee to qualify for the complete defense.
- Subsection (b) provides a defense to a subsequent transferee (i.e., a transferee other than the first transferee) that took in good faith and for value and to a subsequent good-faith transferee from such a person, but in each case only to an action on a money judgment. Subsection (b) is amended to make it consistent with §§ 550(a) and (b) of the Bankruptcy Code by providing that the defense applies to recovery of or from the transferred property or its proceeds, by levy or otherwise, as well as to an action for money judgment.
- Subdivision (e)(2) provides a defense for a constructively voidable transfer (i.e., a transfer that is voidable for reasons other than intent by the debtor to hinder, delay or defraud any creditor of the debtor) if the transfer resulted from the enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code (Secured Transactions). Subdivision (e)(2) is amended to exclude from that defense a "strict foreclosure," (i.e., an acceptance by the secured party of collateral in whole or partial satisfaction of the obligation it secures, without a public sale or judicial foreclosure.) The protection of a strict foreclosure from a voidable transfer challenge is not appropriate if the secured party accepts collateral having a value in excess of the secured obligation and afterwards the debtor is insolvent, the debtor is unable to pay the debtor's debts as they become due, or the debtor is left with unreasonably small capital.
- New subsections (g) and (h) address the burden and standard of proof with respect to proving defenses under this section. In general, the person who invokes the defense carries the burden of establishing the defense by a preponderance of the evidence.

§ 39-23.9, which provides periods of limitation for bringing an action with respect to a voidable transfer or obligation, is amended to make the following stylistic changes:

- The phrase “fraudulent or” is deleted as being unnecessary and the term "cause of action" is change to "claim for relief" because the latter term is used in several new provisions in the Act and in modern uniform acts.
- In subdivisions (1), (2), and (3), "within" is changed to "not later than" because the latter wording is preferred in modern uniform acts.
- In subdivision (3), the phrase "or the obligation was incurred" is deleted because § 39-23.5(b), the insider preference provision, by its terms applies only to a transfer of property; it does not apply to the incurrence of an obligation.

New § 39-23.9A addresses potential choice of law disputes by providing a clear choice of law provision for transactions governed by the Act. Under this section, the voidable transactions law applicable to a transfer or obligation is the law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred. Under this section, a claim for relief under the Act is governed by the law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred. A debtor who is an individual is located at the individual's "principal residence," and a debtor that is an organization is located at its place of business or, if it has more than one place of business, at its chief executive office.

New § 39-23.9B addresses "series organizations," which have emerged as a form of business organization, by providing that the Act applies to the "protected series" of a series organization. In general, subsection (a) defines a series organization as an organization that, under the authority of its state governing law, has created one or more protected series that owns assets separately from the assets of the organization or any other protected series and incurs liability that will be enforceable only against the assets of that protected series. Under subsection (b), a series organization and each protected series of the series organization is a separate person for purposes of the Act. New § 39-23.9B does not itself authorize or prohibit the creation of protected series or series organizations.

New § 39-23.11A is a standard provision in uniform acts that has the effect of opting out of the federal statute applicable to electronic records and signatures, the Electronic Signatures in Global and National Commerce Act (also known as "E-Sign").

§ 39-23.12 is amended to change the short title of the Article from "Uniform Fraudulent Transfer Act" to "Uniform Voidable Transactions Act" to conform to the change in the title of the Act.

Section 2 amends G.S. 50-13.4(f) to make several technical changes and to replace "fraudulent conveyances" with "voidable transactions" in the phrase "Article 3A of Chapter 31 of the General Statutes pertaining to fraudulent conveyances."

Section 3 amends G.S. 50-16(h) to replace "fraudulent conveyances" with "voidable transactions" in the phrase "Article 3A of Chapter 31 of the General Statutes pertaining to fraudulent conveyances."

Section 4 authorizes the printing of official comments and drafters comments.

Section 5 provides that the amendments become effective October 1, 2015, and apply to a transfer made or obligation incurred on or after that date.