39-23.4. Transfer or obligation voidable as to present or future creditor.

(a) A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

(1) With intent to hinder, delay, or defraud any creditor of the debtor; or

(2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

a. Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

b. Intended to incur, or believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

(b) In determining intent under subdivision (a)(1) of this section, consideration may be given, among other factors, to whether:

(1) The transfer or obligation was to an insider;

(2) The debtor retained possession or control of the property transferred after the transfer;

(3) The transfer or obligation was disclosed or concealed;

(4) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) The transfer was of substantially all the debtor's assets;

(6) The debtor absconded;

(7) The debtor removed or concealed assets;

(8) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) The transfer occurred shortly before or shortly after a substantial debt was incurred;

(11) The debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor;

(12) The debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor reasonably should have believed that the debtor would incur debts beyond the debtor's ability to pay as they became due; and

(13) The debtor transferred the assets in the course of legitimate estate or tax planning.

(c) A creditor making a claim for relief under subsection (a) of this section has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

(1997-291, s. 2; 2015-23, s. 1.)

OFFICIAL COMMENT (2014)

1. Section 4(a)(1) is derived from 7 of the Uniform Fraudulent Conveyance Act, which in turn was derived from the Statute of 13 Elizabeth, c. 5 (1571). Factors appropriate for consideration in determining actual intent under Section 4(a)(1) are specified in subsection (b).

2. Section 4, unlike 5, protects creditors of a debtor whose claims arise after as well as before the debtor made or incurred the challenged transfer or obligation. Similarly, there is no requirement in 4(a)(1) that the intent referred to be directed at a creditor existing or identified at the time of transfer or incurrence. For example, promptly after the invention in Pennsylvania of the spendthrift trust, the assets and beneficial interest of which are immune from attachment by the beneficiary's creditors, courts held that a debtor's establishment of a spendthrift trust for the debtor's own benefit is a voidable transfer under the Statute of 13 Elizabeth, without regard to whether the transaction is directed at an existing or identified creditor. *Mackason's Appeal*, 42 Pa. 330, 338-39 (1862); see also, *e.g., Ghormley v. Smith*, 139 Pa. 584, 591-94 (1891); *Patrick v. Smith*, 2 Pa. Super. 113, 119 (1896). *Cf. Restatement (Third) of Trusts* 58(2) (2003) (setting forth a substantially similar rule as a matter of trust law). Likewise, for centuries 4(a)(1) and its predecessors have been employed to invalidate nonpossessory property interests that are thought to be potentially deceptive, without regard to whether the deception is directed at an existing or identified creditor. See, *e.g., McGann v. Capital Sav. Bank & Trust Co.*, 89 A.2d 123, 183-84 (Vt. 1952) (seller's retention of possession of goods after sale held voidable); *Superior Partners v. Prof'l Educ. Network, Inc.*, 485 N.E.2d 1218, 1221 (Ill. App. Ct. 1985) (similar); *Clow v. Woods*, 5 Serg. & Rawle 275 (Pa. 1819) (holding that a nonpossessory chattel mortgage is voidable, in the absence of a system for giving public notice of such interests such as is today supplied by Article 9 of the Uniform Commercial Code).

Section 4(a)(1) has the meaning elaborated in the preceding paragraph, but it is of course possible that a jurisdiction in which this Act is in force might enact other legislation that modifies the results of the particular examples given to illustrate that meaning. For example, some states have enacted legislation authorizing the establishment and funding of self-settled spendthrift trusts, subject to specified conditions. In such a state, such legislation will supersede the historical interpretation referred to in the preceding paragraph, either expressly or by necessary implication, with respect to allowed transfers to such a statutorily-validated trust. See, *e.g.*, Del. Code. Ann. tit. 12, 3572(a), (b) (2014). See also Comment 8. Likewise, the historical skepticism of nonpossessory property interests has been superseded as to security interests in personal property by the Uniform Commercial Code. See Comment 9.

3. Section 4(a)(2) is derived from 5 and 6 of the Uniform Fraudulent Conveyance Act but substitutes "reasonably equivalent value" for "fair consideration." The transferee's good faith was an element of "fair consideration" as defined in 3 of the Uniform Fraudulent Conveyance Act, and lack of fair consideration was one of the elements of a fraudulent transfer as defined in four sections of the Uniform Fraudulent Conveyance Act. The transferee's good faith is irrelevant to a determination of the adequacy of the consideration under this Act, but lack of good faith may be a basis for withholding protection of a transferee or obligee under 8.

4. Unlike the Uniform Fraudulent Conveyance Act, this Act does not prescribe different tests for voidability of a transfer that is made for the purpose of security and a transfer that is intended to be absolute. The premise of this Act is that when a transfer is for security only, the equity or value of the asset that exceeds the amount of the debt secured remains available to unsecured creditors and thus cannot be regarded as the subject of a voidable transfer merely because of the encumbrance resulting from an otherwise valid security transfer. Disproportion between the value of the asset securing the debt and the size of the debt secured does not, in the absence of circumstances indicating a purpose to hinder, delay, or defraud creditors, constitute an impermissible hindrance to the enforcement of other

creditors' rights against the debtor-transferor. *Cf.* U.C.C. 9-401(b) (2014) (providing that a debtor's interest in collateral subject to a security interest is transferable notwithstanding an agreement with the secured party prohibiting transfer).

5. Subparagraph (i) of 4(a)(2) is an adaptation of 5 of the Uniform Fraudulent Conveyance Act but substitutes "unreasonably small [assets] in relation to the business or transaction" for "unreasonably small capital." The reference to "capital" in the Uniform Fraudulent Conveyance Act might be interpreted, incorrectly, to refer to the par value of stock or to the consideration received for stock issued. The special meanings of "capital" in corporation law have no relevance in the law of voidable transfers. The subparagraph focuses attention on whether the amount of all the assets retained by the debtor was inadequate, *i.e.*, unreasonably small, in light of the needs of the business or transaction in which the debtor was engaged or about to engage.

Subparagraph (ii) of 4(a)(2) is an adaptation of 6 of the Uniform Fraudulent Conveyance Act, which relates to a debtor that has or will have debts beyond the debtor's ability to pay as they become due (a condition that is sometimes referred to as "insolvency in the equity sense"). Subparagraph (ii) carries forward the previous Act's language capturing a debtor that "intends" or "believes" that the debtor is or will be unable to pay the debtor's debts as they become due, and adds to that language capturing a debtor that "reasonably should have believed" the same. The added language makes clear that subparagraph (ii) also captures a debtor that, on the basis of objective assessment, has or will have debts beyond the debtor's ability to pay as they become due, regardless of the debtor's subjective belief.

6. Subsection (b) is a nonexclusive catalogue of factors appropriate for consideration by the court in determining whether the debtor had an actual intent to hinder, delay, or defraud one or more creditors. Proof of the existence of any one or more of the factors enumerated in subsection (b) may be relevant evidence as to the debtor's actual intent but does not create a presumption that the debtor has made a voidable transfer or incurred a voidable obligation. The list of factors includes most of the so-called "badges of fraud" that have been recognized by the courts in construing and applying the Statute of 13 Elizabeth and 7 of the Uniform Fraudulent Conveyance Act. Proof of the presence of certain badges in combination establishes voidability conclusively - *i.e.*, without regard to the actual intent of the debtor - when they concur as provided in 4(a)(2) or in 5. The fact that a transfer has been made to a relative or to an affiliated corporation has not been regarded as a badge of fraud sufficient to warrant avoidance when unaccompanied by any other evidence of intent to hinder, delay, or defraud creditors. The courts have uniformly recognized, however, that a transfer to a closely related person warrants close scrutiny of the other circumstances, including the nature and extent of the consideration exchanged. See 1 G. Glenn, Fraudulent Conveyances and Preferences 307 (Rev. ed. 1940). The second, third, fourth, and fifth factors listed are all adapted from the classic catalogue of badges of fraud provided by Lord Coke in *Twyne's Case*, 3 Coke 80b, 76 Eng.Rep. 809 (Star Chamber 1601). Lord Coke also included the use of a trust and the recitation in the instrument of transfer that it "was made honestly, truly, and bona fide," but the use of the trust is voidable only when accompanied by indicia of intent to hinder, delay, or defraud creditors, and recitals of "good faith" can no longer be regarded as significant evidence of intent to hinder, delay, or defraud creditors.

7. In considering the factors listed in 4(b) a court should evaluate all the relevant circumstances involving a challenged transfer or obligation. Thus the court may appropriately take into account all indicia negativing as well as those suggesting intent to hinder, delay, or defraud creditors, as illustrated in the following reported cases:

(a) Whether the transfer or obligation was to an insider: *Salomon v. Kaiser (In re Kaiser)*, 722 F.2d 1574, 1582-83 (2d Cir. 1983) (insolvent debtor's purchase of two residences in the name of his spouse and the creation of a dummy corporation for the purpose of concealing assets held to evidence intent to hinder, delay, or defraud creditors); *Banner Construction Corp. v. Arnold*, 128 So.2d 893 (Fla.Dist.App. 1961) (assignment by one corporation to another having identical directors and stockholders constituted a badge of fraud); *Travelers Indemnity Co. v. Cormaney*, 258 Iowa 237, 138 N.W.2d 50 (1965) (transfer between spouses said to be a circumstance that shed suspicion on the transfer and that with other circumstances warranted avoidance); *Hatheway v. Hanson*, 230 Iowa 386, 297 N.W. 824 (1941) (transfer from parent to child said to require a critical examination of surrounding circumstances, which, together

with other indicia of intent to hinder, delay, or defraud creditors, warranted avoidance); *Lumpkins v. McPhee*, 59 N.M. 442, 286 P.2d 299 (1955) (transfer from daughter to mother said to be indicative of intent to hinder, delay, or defraud creditors, but transfer held not to be voidable due to adequacy of consideration and delivery of possession by transferor).

(b) Whether the transferor retained possession or control of the property after the transfer: *Harris v. Shaw*, 224 Ark. 150, 272 S.W.2d 53 (1954) (retention of property by transferor said to be a badge of fraud and, together with other badges, to warrant avoidance of transfer); *Stephens v. Reginstein*, 89 Ala. 561, 8 So. 68 (1890) (transferor's retention of control and management of property and business after transfer held material in determining transfer to be voidable); *Allen v. Massey*, 84 U.S. (17 Wall.) 351 (1872) (joint possession of furniture by transferor and transferee considered in holding transfer to be voidable); *Warner v. Norton*, 61 U.S. (20 How.) 448 (1857) (surrender of possession by transferor deemed to negate allegations of intent to hinder, delay, or defraud creditors).

(c) Whether the transfer or obligation was concealed or disclosed: *Walton v. First National Bank*, 13 Colo. 265, 22 P. 440 (1889) (agreement between parties to conceal the transfer from the public said to be one of the strongest badges of fraud); *Warner v. Norton*, 61 U.S. (20 How.) 448 (1857) (although secrecy said to be a circumstance from which, when coupled with other badges, intent to hinder, delay, or defraud creditors may be inferred, transfer was held not to be voidable when made in good faith and transferor surrendered possession); *W.T. Raleigh Co. v. Barnett*, 253 Ala. 433, 44 So.2d 585 (1950) (failure to record a deed in itself said not to evidence intent to hinder, delay, or defraud creditors, and transfer held not to be voidable).

(d) Whether, before the transfer was made or obligation was incurred, a creditor sued or threatened to sue the debtor: *Harris v. Shaw*, 224 Ark. 150, 272 S.W.2d 53 (1954) (transfer held to be voidable when causally connected to pendency of litigation and accompanied by other badges of fraud); *Pergrem v. Smith*, 255 S.W.2d 42 (Ky.App. 1953) (transfer in anticipation of suit deemed to be a badge of fraud; transfer held voidable when accompanied by insolvency of transferor who was related to transferee); *Bank of Sun Prairie v. Hovig*, 218 F. Supp. 769 (W.D.Ark. 1963) (although threat or pendency of litigation said to be an indicator of intent to hinder, delay, or defraud creditors, transfer was held not to be voidable when adequate consideration and good faith were shown).

(e) Whether the transfer was of substantially all the debtor's assets: *Walbrun v. Babbitt*, 83 U.S. (16 Wall.) 577 (1872) (sale by insolvent retail shop owner of all of his inventory in a single transaction held to be voidable); *Cole v. Mercantile Trust Co*., 133 N.Y. 164, 30 N.E. 847 (1892) (transfer of all property before plaintiff could obtain a judgment held to be voidable); *Lumpkins v. McPhee*, 59 N.M. 442, 286 P.2d 299 (1955) (although transfer of all assets said to indicate intent to hinder, delay, or defraud creditors, transfer held not to be voidable because full consideration was paid and transferor surrendered possession).

(f) Whether the debtor had absconded: *In re Thomas*, 199 F. 214 (N.D.N.Y. 1912) (when debtor collected all of his money and property with the intent to abscond, intent to hinder, delay, or defraud creditors was held to be shown).

(g) Whether the debtor had removed or concealed assets: *Bentley v. Young*, 210 F. 202 (S.D.N.Y. 1914), *aff'd*, 223 F. 536 (2d Cir. 1915) (debtor's removal of goods from store to conceal their whereabouts and to sell them held to render sale voidable); *Cioli v. Kenourgios*, 59 Cal.App. 690, 211 P. 838 (1922) (debtor's sale of all assets and shipment of proceeds out of the country held to be voidable notwithstanding adequacy of consideration).

(h) Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred: *Toomay v. Graham*, 151 S.W.2d 119 (Mo.App. 1941) (although mere inadequacy of consideration said not to be a badge of fraud unless it is grossly inadequate, transfer held to be voidable when accompanied by other badges of fraud); *Texas Sand Co. v. Shield*, 381 S.W.2d 48 (Tex. 1964) (inadequate consideration said to be an indicator of intent to hinder, delay, or defraud creditors, and transfer held to be voidable because of inadequate consideration, pendency of suit, family relationship of transferee, and fact that all nonexempt property was transferred); *Weigel v. Wood*, 355 Mo. 11, 194 S.W.2d 40 (1946) (although inadequate consideration

said to be a badge of fraud, transfer held not to be voidable when inadequacy not gross and not accompanied by any other badge; fact that transfer was from father to son held not sufficient to establish intent to hinder, delay, or defraud creditors).

(i) Whether the debtor was insolvent or became insolvent shortly after the transfer was made or obligation was incurred: *Harris v. Shaw*, 224 Ark. 150, 272 S.W. 2d 53 (1954) (insolvency of transferor said to be a badge of fraud and transfer held voidable when accompanied by other badges of fraud); *Bank of Sun Prairie v. Hovig*, 218 F. Supp. 769 (W.D. Ark. 1963) (although the insolvency of the debtor said to be a badge of fraud, transfer held not voidable when debtor was shown to be solvent, adequate consideration was paid, and good faith was shown, despite the pendency of suit); *Wareheim v. Bayliss*, 149 Md. 103, 131 A. 27 (1925) (although insolvency of debtor acknowledged to be an indicator of intent to hinder, delay, or defraud creditors, transfer held not to be voidable when adequate consideration was paid and whether debtor was insolvent in fact was doubtful).

(j) Whether the transfer occurred shortly before or shortly after a substantial debt was incurred: *Commerce Bank of Lebanon v. Halladale A Corp*., 618 S.W. 2d 288, 292 (Mo.App. 1981) (when transferors incurred substantial debts near in time to the transfer, transfer was held to be voidable due to inadequate consideration, close family relationship, the debtor's retention of possession, and the fact that almost all the debtor's property was transferred).

(k) Whether the debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor: The wrong addressed by 4(b)(11) is collusive and abusive use of a lienor's superior position to eliminate junior creditors while leaving equity holders in place, perhaps unaffected. The kind of disposition sought to be reached is exemplified by that found in *Northern Pacific Co. v. Boyd*, 228 U.S. 482, 502-05 (1913), the leading case in establishing the absolute priority doctrine in reorganization law. There the Court held that a reorganization whereby the secured creditors and the management-owners retained their economic interests in a railroad through a foreclosure that cut off claims of unsecured creditors against its assets was in effect a voidable disposition. See Bruce A. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan.L.Rev. 69, 74-83 (1991). For cases in which an analogous injury to unsecured creditors was inflicted by a lienor and a debtor, see *Voest-Alpine Trading USA Corp. v. Vantage Steel Corp*., 919 F.2d 206 (3d Cir. 1990) (lender foreclosed on assets of steel company at 5:00 p.m. on a Friday, then transferred the assets to an affiliate of the debtor; lender made a loan to the affiliate to enable it to purchase at the foreclosure sale on almost the same terms as the old loan; new business opened Monday morning); *Jackson v. Star Sprinkler Corp. of Florida*, 575 F.2d 1223, 1231-34 (8th Cir. 1978); *Heath v. Helmick*, 173 F.2d 157, 161-62 (9th Cir. 1949); *Toner v. Nuss*, 234 F. Supp. 457, 461-62 (E.D.Pa. 1964); and see *In re Spotless Tavern Co.*, Inc., 4 F. Supp. 752, 753, 755 (D.Md. 1933).

8. The phrase "hinder, delay, or defraud" in 4(a)(1), carried forward from the primordial Statute of 13 Elizabeth, is potentially applicable to any transaction that unacceptably contravenes norms of creditors' rights. Section 4(a)(1) is sometimes said to require "actual fraud," by contrast to 4(a)(2) and 5(a), which are said to require "constructive fraud." That shorthand is highly misleading. Fraud is not a necessary element of a claim for relief under any of those provisions. By its terms, 4(a)(1) applies to a transaction that "hinders" or "delays" a creditor, even if it does not "defraud" the creditor. See, *e.g., Shapiro v. Wilgus*, 287 U.S. 348, 354 (1932); *Means v. Dowd*, 128 U.S. 273, 288-89 (1888); *Consove v. Cohen (In re Roco Corp.)*, 701 F.2d 978, 984 (1st Cir. 1983); *Empire Lighting Fixture Co. v. Practical Lighting Fixture Co.*, 20 F.2d 295, 297 (2d Cir. 1927); *Lippe v. Bairnco Corp.*, 249 F. Supp. 2d 357, 374 (S.D.N.Y. 2003). "Hinder, delay, or defraud" is best considered to be a single term of art describing a transaction that unacceptably contravenes norms of creditors' rights. Such a transaction need not bear any resemblance to common-law fraud. Thus, the Supreme Court held a given transfer voidable because made with intent to "hinder, delay, or defraud" creditors, but emphasized: "We have no thought in so holding to impute to [the debtor] a willingness to participate in conduct known to be fraudulent…. [He] acted in the genuine belief that what [he] planned was fair and lawful. Genuine the belief was, but mistaken it was also. Conduct and purpose have a quality imprinted on them by the law." *Shapiro v. Wilgus*. 287 U.S. 348, 357 (1932).

Diminution of the assets available to the debtor's creditors is not necessarily required to "hinder, delay, or defraud" creditors. For example, the age-old legal skepticism of nonpossessory property interests,

which stems from their potential for deception, has often resulted in their avoidance under 4(a)(1) or its predecessors. See Comments 2 and 7(b); *cf.* Comment 9. A transaction may "hinder, delay, or defraud" creditors although it neither reduces the assets available to the debtor's creditors nor involves any potential deception. See, *e.g., Shapiro v. Wilgus*, 287 U.S. 348 (1932) (holding voidable a solvent individual debtor's conveyance of his assets to a wholly-owned corporation for the purpose of instituting a receivership proceeding not available to an individual).

A transaction that does not place an asset entirely beyond the reach of creditors may nevertheless "hinder, delay, or defraud" creditors if it makes the asset more difficult for creditors to reach. Simple exchange by a debtor of an asset for a less liquid asset, or disposition of liquid assets while retaining illiquid assets, may be voidable for that reason. See, *e.g., Empire Lighting Fixture Co. v. Practical Lighting Fixture Co.*, 20 F.2d 295, 297 (2d Cir. 1927) (L. Hand, J.) (credit sale by a corporation to an affiliate of its plant, leaving the seller solvent with ample accounts receivable, held voidable because made with intent to hinder creditors of the seller, due to the comparative difficulty of creditors realizing on accounts receivable under then-current collection practice). Overcollateralization of a debt that is made with intent to hinder the debtor's creditors, by rendering the debtor's equity in the collateral more difficult for creditors to reach, is similarly voidable. See Comment 4. Likewise, it is voidable for a debtor intentionally to hinder creditors by transferring assets to a wholly-owned corporation or other organization, as may be the case if the equity interest in the organization is more difficult to realize upon than the assets (either because the equity interest is less liquid, or because the applicable procedural rules are more demanding). See, *e.g., Addison v. Tessier*, 335 P.2d 554, 557 (N.M. 1959); *First Nat'l Bank. v. F. C. Trebein Co.*, 52 N.E. 834, 837-38 (Ohio 1898); Anno., 85 A.L.R. 133 (1933).

Under the same principle, 4(a)(1) would render voidable an attempt by the owners of a corporation to convert it to a different legal form (*e.g.*, limited liability company or partnership) with intent to hinder the owners' creditors, as may be the case if an owner's interest in the alternative organization would be subject only to a charging order, and not to execution (which would typically be available against stock in a corporation). See, *e.g., Firmani v. Firmani*, 752 A.2d 854, 857 (N.J. Super. Ct. App. Div. 2000); *cf. Interpool Ltd. v. Patterson*, 890 F. Supp. 259, 266-68 (S.D.N.Y. 1995) (similar, but relying on a "good faith" requirement of the former Uniform Fraudulent Conveyance Act rather than that act's equivalent of 4(a)(1)). If such a conversion is done with intent to hinder creditors, it contravenes 4(a)(1) regardless of whether it is effected by conveyance of the corporation's assets to a new entity or by conversion of the corporation to the alternative form. In both cases the owner begins with the stock of the corporation and ends with an ownership interest in the alternative organization, a property right with different attributes. Either is a "transfer" under the designedly sweeping language of 1(16), which encompasses "every mode…of…parting with an asset or an interest in an asset." *Cf., e.g., United States v. Sims (In re Feiler)*, 218 F.3d 948 (9th Cir. 2000) (debtor's irrevocable election under the Internal Revenue Code to waive carryback of net operating losses is a "transfer" under the substantially similar definition in the Bankruptcy Code); *Weaver v. Kellogg*, 216 B.R. 563, 573-74 (S.D. Tex. 1997) (exchange of notes owed to the debtor for new notes having different terms is a "transfer" by the debtor under that definition).

In 4(a)(1), the phrase "hinder, delay, or defraud," like the word "intent," 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). The line between permissible and impermissible grants cannot coherently be drawn by reference to the debtor's subjective mental state, for a rational person knows the natural consequences of his actions, and that includes the adverse consequences to unsecured creditors of any grant of a security interest. See, *e.g., Dean v. Davis*, 242 U.S. 438, 444 (1917) (equating an act whose "obviously necessary effect" is to hinder, delay, or defraud creditors with an act intended to hinder, delay, or defraud creditors); *United States v. Tabor Court Realty Corp.*, 803 F.3d 1288, 1305 (3rd Cir. 1986) (holding that the trial court's finding of intent to hinder, delay, or defraud creditors properly followed from its finding that the debtor could have foreseen the effect of its act on its creditors, because "a party is deemed to have intended the natural consequences of his acts"); *In re Sentinel Management Group Inc.*, 728 F.3d 660, 667 (7th Cir. 2013). Whether a transaction is captured by 4(a)(1) ultimately depends upon whether the transaction unacceptably contravenes norms of creditors' rights, given the devices legislators and courts have allowed debtors that may interfere with those rights. Section 4(a)(1) is the regulatory tool of last resort that restrains debtor ingenuity to decent limits.

Thus, for example, suppose that entrepreneurs organize a business as a limited liability company, contributing assets to capitalize it, in the ordinary situation in which none of the owners has particular reason to anticipate personal liability or financial distress and no other unusual facts are present. Assume that the LLC statute has the creditor-thwarting feature of precluding execution upon equity interests in the LLC and providing only for charging orders against such interests. Notwithstanding that feature, the owners' transfers of assets to capitalize the LLC is not voidable under 4(a)(1) as in force in the same state. The legislature in that state, having created the LLC vehicle having that feature, must have expected it to be used in such ordinary circumstances. By contrast, if owners of an existing business were to reorganize it as an LLC under such a statute when the clouds of personal liability or financial distress have gathered over some of them, and with the intention of gaining the benefit of that creditor-thwarting feature, the transfer effecting the reorganization should be voidable under 4(a)(1), at least absent a clear indication that the legislature truly intended the LLC form, with its creditor-thwarting feature, to be available even in such circumstances.

Because the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting 4(a)(1) as in force in a given jurisdiction. For example, as noted in Comment 2, the language of 4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under 4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. (Other facts might still render the transfer voidable under X's enactment of 4(a)(1).) By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under 4(a)(1) as in force in Y.

9. This Act is not an exclusive law on the subject of voidable transfers and obligations. See 1, Comment 2. For example, the Uniform Commercial Code supplements or modifies the operation of this Act in numerous ways. Instances include the following:

(a) U.C.C. 2-402(2) (2014) recognizes the generally prevailing rule that retention of possession of goods by a seller may be voidable, but limits the application of the rule by negating any imputation of voidability from "retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification." (Indeed, independently of 2-402(2), retention of possession of goods in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification should not in itself be considered to "hinder, delay, or defraud" any creditor of the merchant-seller under 4(a)(1).)

(b) Section 2A-308(1) provides a rule analogous to 2-402(2) for situations in which a lessor retains possession of goods that are subject to a lease contract. Section 2A-308(3) provides that retention of possession of goods by the seller-lessee in a sale-leaseback transaction does not render the transaction voidable by a creditor of the seller-lessee if the buyer bought for value and in good faith.

(c) This Act does not preempt statutes governing bulk transfers, including Article 6 of the Uniform Commercial Code in jurisdictions in which it remains in force.

(d) Section 9-205 precludes treating a security interest in personal property as voidable on account of various enumerated features it may have. Among other things, 9-205 immunizes a security interest in tangible property from being avoided on account of the secured party not being in possession of the property, notwithstanding the historical skepticism of nonpossessory property interests.

This Act operates independently of rules in an organic statute applicable to a business organization that limit distributions by the organization to its equity owners. Compliance with those rules does not

insulate such a distribution from being voidable under this Act. It is conceivable that such an organic statute might contain a provision preempting the application of this Act to such distributions. *Cf.* Model Business Corporation Act 152 (optional provision added in 1979 preempting the application of "any other statutes of this state with respect to the legality of distributions"; deleted 1984). Such a preemptive statute of course must be respected if applicable, but choice of law considerations may well render it inapplicable. See, *e.g., Faulkner v. Kornman (In re The Heritage Organization, L.L.C.)*, 413 B.R. 438, 462-63 (Bankr. N.D. Tex. 2009) (action under the Texas enactment of this Act challenging a distribution by a Delaware limited liability company to its members; held, a provision of the Delaware LLC statute imposing a three-year statute of repose on an action under "any applicable law" to recover a distribution by a Delaware LLC did not apply, because choice of law rules directed application of the voidable transfer law of Texas).

10. Subsection (c) was added in 2014. Sections 2(b), 4(c), 5(c), 8(g), and 8(h) together provide uniform rules on burdens and standards of proof relating to the operation of this Act.

Pursuant to subsection (c), proof of intent to "hinder, delay, or defraud" a creditor under 4(a)(1) is sufficient if made by a preponderance of the evidence. That is the standard of proof ordinarily applied in civil actions. Subsection (c) thus rejects cases that have imposed an extraordinary standard, typically "clear and convincing evidence," by analogy to the standard commonly applied to proof of common-law fraud. That analogy is misguided. By its terms, 4(a)(1) applies to a transaction that "hinders" or "delays" a creditor even if it does not "defraud," and a transaction to which 4(a)(1) applies need not bear any resemblance to common-law fraud. See Comment 8. Furthermore, the extraordinary standard of proof commonly applied to common-law fraud originated in cases that were thought to involve a special danger that claims might be fabricated. In the earliest such cases, a court of equity was asked to grant relief on claims that were unenforceable at law for failure to comply with the Statute of Frauds, the Statute of Wills, or the parol evidence rule. In time, extraordinary proof also came to be required in actions seeking to set aside or alter the terms of written instruments. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983) and sources cited therein. Those reasons for extraordinary proof do not apply to claims for relief under 4(a)(1).

For similar reasons, 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). The elements of a claim under 4(a)(1) are very different from the elements of a claim of common-law fraud. Furthermore, the reasons for such extraordinary pleading requirements do not apply to a claim under 4(a)(1). Unlike common-law fraud, a claim under 4(a)(1) is not unusually susceptible to abusive use in a "strike suit," nor is it apt to be of use to a plaintiff seeking to discover unknown wrongs. Likewise, a claim under 4(a)(1) is unlikely to cause significant harm to the defendant's reputation, for the defendant is the transferee or obligee, and the elements of the claim do not require the defendant to have committed even an arguable wrong. See *Janvey v. Alguire*, 846 F. Supp. 2d 662, 675-77 (N.D. Tex. 2011); *Carter-Jones Lumber Co. v. Benune*, 725 N.E.2d 330, 331-33 (Ohio App. 1999). *Cf.* Federal Rules of Civil Procedure, Appendix, Form 21 (2010) (illustrative form of complaint for a claim under 4(a)(1) or similar law, which Rule 84 declares sufficient to comply with federal pleading rules).

11. Subsection (c) allocates to the party making a claim for relief under 4 the burden of persuasion as to the elements of the claim. Courts should not apply nonstatutory presumptions that reverse that allocation, and should be wary of nonstatutory presumptions that would dilute it. The command of 13 - that this Act is to be applied so as to effectuate its purpose of making uniform the law among states enacting it - applies with particular cogency to nonstatutory presumptions. Given the elasticity of key terms of this Act (*e.g.*, "hinder, delay, or defraud") and the potential difficulty of proving others (*e.g.*, the financial condition tests in 4(a)(2) and 5), employment of divergent nonstatutory presumptions by enacting jurisdictions may render the law nonuniform as a practical matter. It is not the purpose of subsection (c) to forbid employment of any and all nonstatutory presumptions. Indeed, in some instances a judicially-crafted presumption applied under this Act or its predecessors has won such favor as to be codified as a separate statutory creation. Examples include the bulk sales laws, the absolute priority rule applicable to reorganizations under Bankruptcy Code 1129(b)(2)(B)(ii) (2014), and the so-called "constructive fraud" provisions of 4(a)(2) and 5(a) of this Act itself. However, subsection (c) and 13 mean, at the least, that a nonstatutory presumption is suspect if it would alter the statutorily-allocated

burden of persuasion, would upset the policy of uniformity, or is an unwarranted carrying-forward of obsolescent principles. An example of a nonstatutory presumption that should be rejected for those reasons is a presumption that the transferee bears the burden of persuasion as to the debtor's compliance with the financial condition tests in 4(a)(2) and 5, in an action under those provisions, if the transfer was for less than reasonably equivalent value (or, as another example, if the debtor was merely in debt at the time of the transfer). See *Fidelity Bond & Mtg. Co. v. Brand*, 371 B.R. 708, 716-22 (E.D. Pa. 2007) (rejecting such a presumption previously applied in Pennsylvania).

NORTH CAROLINA COMMENT

Editor's Note. - The North Carolina Comment below is the drafters' comment to the State's version of the Uniform Fraudulent Transfers Act as enacted in 1997.

This section and N.C. Gen. Stat. 39-23.5 are the primary provisions of the UFTA, as they define which transfers are voidable.

This section differs from the version promulgated by the NCCUSL in three respects. The General Assembly deleted the phrase "or reasonably should have believed" in subsubdivision (a)(2)b. and added subdivision (b)(12). Because the drafters believed that this change converted constructive intent from an element of a conveyance deemed fraudulent to a factor to be considered in determining intent, the phrase "actual intent" was changed to "intent" in subsubdivision (a)(2)b. and the introductory language of subsection (b). The General Assembly also added subdivision (b)(13).

The reference to "obligation incurred" in subsection (a) represents a change from prior North Carolina law, and reflects a recognition that a debtor can harm creditors by incurring a fraudulent debt as well as by making a fraudulent transfer.

Except for the change described in the preceding sentence, subdivision (a)(1) does not change fraudulent transfer law in North Carolina. Under prior law, once a creditor had shown actual fraud on the part of the debtor, the transfer was void whether the creditor's claim was in existence at the time of the transaction or arose subsequently. *See generally* Howard, 50 *N.C. L. Rev.* at 887. Subdivision (a)(1) is subject to an important limitation: under N.C. Gen. Stat. 39-23.8(a), a transfer or obligation is not voidable under subdivision (a)(1) against a person who took in good faith and for a reasonably equivalent value. With that limitation, subdivision (a)(1) is consistent with prior North Carolina law. *See* former N.C. Gen. Stat. 39-19; *Aman v. Walker, 165 N.C. 224,* 227, 81 S.E. 162, 164 (1914) (principle four).

Subdivision (a)(2) is intended to address transactions for less than "reasonably equivalent value" that leave a debtor undercapitalized (*see* Official Comment 4) and applies both to present and subsequent creditors. It should be contrasted with N.C. Gen. Stat. 39-23.5(a), which addresses transactions for less than "reasonably equivalent value" made when a debtor is or becomes "insolvent" but which applies only to creditors whose claims arose before the transaction.

Prior North Carolina law invalidated transactions for less than a "reasonably fair price" when the debtor failed "to retain property fully sufficient and available to pay his debts then existing." *Aman v. Walker, 165 N.C. 224,* 227, 18 S.E. 162, 164 (1914) (principle two). The rule clearly applied to transactions occurring when a debtor was "insolvent" in a "balance sheet" sense. *See* North Carolina Comment to N.C. Gen. Stat. 39-23.2. Under prior law a subsequent creditor could use the fact that a conveyance left a business with "unreasonably small capital" as evidence of fraud, but the creditor nevertheless would have to prove fraudulent intent in order to void the conveyance. Howard, *50 N.C. L. Rev.* at 888.

Subdivision (a)(2) refers to transactions causing a debtor to incur debts beyond the debtor's ability to pay as they become due. As noted, under prior law when a debtor engaged in a transaction for less than a "reasonably fair price" and failed "to retain property fully sufficient and available to pay his creditors then existing," the transaction generally was voidable only by a creditor whose claim was in existence as of the time of the transaction in question. *See* North Carolina Comment to N.C. Gen. Stat. 39-23.5. Subdivision

(a)(2) broadens prior law since it can be invoked "whether the creditor's claim arose before or after" the transaction.

Subsection (b) is a non-exclusive list of "badges of fraud" that can be considered in establishing a debtor's fraudulent intent within the meaning of subdivision (a)(1). North Carolina law has long recognized "badges of fraud" in fraudulent conveyance litigation, *see, e.g., Peebles v. Horton, 64 N.C. 374,* 377 (1870), and decisions have identified several of the factors enumerated in subsection (b). Among these factors are close family relationship (*Wurlitzer Dist. Corp. v. Schofield, 44 N.C. App. 520,* 529, 261 S.E.2d 688, 694 (1980), *Nytco Leasing, Inc. v. Southeastern Motels, Inc., 40 N.C. App. 120,* 130, 252 S.E.2d 826, 833 (1979), *Unaka & City Nat'l Bank v. Lewis, 201 N.C. 148,* 156, 159 S.E. 312, 316-17 (1931), *Peeler v. Peeler, 109 N.C. 628,* 634, 14 S.E. 59, 62 (1891)); retention of possession (*Piedmont Sav. Bank v. Levy, 138 N.C. 274,* 50 S.E. 657 (1905)); secrecy (*Reiger v. Davis, 67 N.C. 185,* 189 (1872)); and pending litigation (*Helms v. Green, 105 N.C. 251,* 262, 11 S.E. 470, 474 (1890)). As noted above, subdivision (b)(12) incorporates language deleted from UFTA 4(a), where it would have had a more automatic effect, rather than being a "factor" that "may" be considered, and subdivision (b)(13) is wholly new.

Under prior law certain combinations of "badges of fraud" could give rise to a rebuttable presumption of fraudulent intent. Howard, 50 *N.C. L. Rev.* at 891-893. According to Official Comment 5, however, proof of the existence of any one or more of the factors enumerated in subsection (b) may be relevant evidence as to the debtor's intent but does not create a presumption that the debtor has engaged in a fraudulent transaction.

Editor's Note. - Session Laws 2015-23, s. 4 provides: "The Revisor of Statutes shall cause to be printed, as annotations to the published General Statutes, all relevant portions of the Official Comments to the Uniform Voidable Transactions Act and all explanatory comments of the drafters of this act as the Revisor may deem appropriate."

Session Laws 2015-23, s. 5, provides: "This act becomes effective October 1, 2015, and applies to a transfer made or obligation incurred on or after that date. For purposes of this section, a transfer is made and an obligation is incurred at the time provided in G.S. 39-23.6, as amended by this act."

Effect of Amendments. - Session Laws 2015-23, s. 1, effective October 1, 2015, rewrote the section heading; substituted "voidable" for "fraudulent" near the beginning of subsection (a); made a minor stylistic change in subdivision (b)(11); and added subsection (c). For applicability and effective date, see editor's note.