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**Draft 6.8.04**

\_\_\_\_\_, 2004

Honorable Joseph L. Bruno  
Majority Leader and President Pro Tem  
New York State Senate

Honorable Sheldon Silver  
Speaker, New York State Assembly

Re: New York's Fraudulent Transfer Law

Dear Sirs:

The Committee on Uniform State Laws and the Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York (the "Committees") respectfully recommend that the New York Legislature repeal New York's existing fraudulent transfer statute,<sup>1</sup> which is based on the antiquated Uniform Fraudulent Conveyance Act<sup>2</sup> ("UFCA"), and replace it with a statute based on the Uniform Fraudulent Transfer Act<sup>3</sup> ("UFTA"). This letter summarizes the reasons for that recommendation.

Every year countless business transactions take place in New York and are governed by New York's fraudulent transfer law. Increasingly, courts have been required to analyze and apply that law, especially in the context of the large number of bankruptcy cases filed over the past few years.<sup>4</sup>

New York's existing fraudulent transfer statute, which was enacted in 1925, is based on the UFCA, which was promulgated by the National Conference of Commissioners on Uniform

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<sup>1</sup> N.Y. DEBTOR AND CREDITOR LAW ("DCL") §§ 270-281 (McKinney 2000 & Supp. 2003).

<sup>2</sup> 7A U.L.A. 1 (1999 & Supp. 2002).

<sup>3</sup> *Id.* at 266.

<sup>4</sup> State fraudulent transfer laws are applicable in bankruptcy cases because Section 544(b)(1) of the Bankruptcy Code authorizes a trustee to avoid transfers that are avoidable under non-bankruptcy law.

State Laws (“NCCUSL”) in 1918. The UFCA remains the source of only four states’ fraudulent transfer laws.<sup>5</sup>

The UFTA was adopted by NCCUSL in 1984. It was drafted against the backdrop of the Uniform Commercial Code (“UCC”) and draws from the Bankruptcy Code’s modern fraudulent transfer provisions. The UFTA has been adopted by 39 states and the District of Columbia.

Thus, New York’s enactment of a fraudulent transfer statute based on the UFTA would promote uniformity among the states and, in so doing, create a more predictable, and therefore more favorable, business environment. Uniformity is exceptionally desirable because choice of law issues arising with regard to fraudulent transfers are unusually uncertain and ambiguous. In addition, such enactment would promote uniformity with the Bankruptcy Code and, in so doing, enhance predictability by reducing the likelihood that a transaction would be treated differently for this purpose before and after the commencement of a bankruptcy case.

The Committees believe that the UFTA is superior to the UFCA. Both statutes provide for the avoidance of a transfer of property made by a person or an obligation incurred by a person if (1) the transfer was made or the obligation was incurred by the person with intent to hinder, delay or defraud the person’s creditors or (2) the person was in a condition of financial stringency at the time of the transfer or incurrence and did not receive equivalent value in exchange for the property transferred or obligation incurred. The UFTA, however, is clearer, more consistent with other laws, and more modern and practical. Certain of the differences between the two statutes are summarized below.

### **Principal Differences between the UFTA and the New York UFCA**

1. The UFTA contains a clear and uniform statute of limitations (§ 9)<sup>6</sup> In the case of actual fraud, the statute of limitations is the later of four years after the transfer is made and one year after the transfer reasonably could have been discovered by the claimant. In the case of constructive fraud, the statute of limitations is four years after the transfer is made. The UFCA does not contain a statute of limitations, relying instead on other state law. In New York, the applicable limitations period is six years (CPLR § 213, subd. 1).

2. Unlike the UFCA, the UFTA (§ 6) defines when a transfer is made or obligation incurred for purposes of the statute, and thus clarifies when the transferor’s financial condition and the value of consideration provided by the transferee are to be measured and when the statute of limitations begins to run. Under the UFTA, a transfer is made (1) when a transfer of non-fixture real property is perfected as against a good-faith purchaser and (2) when a transfer of another asset is perfected as against a judicial lien creditor. An oral obligation is incurred

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<sup>5</sup> Maryland, Tennessee, Wyoming and New York are the only remaining states whose fraudulent transfer statutes are based on the UFCA.

<sup>6</sup> The statute of limitations in UFTA §9 extinguishes actions commenced after the prescribed limitations period has passed, including those commenced by governmental entities. It therefore rejects the holding of *U.S. v. Gleneagles Investment Co., Inc.*, 565 F. Supp. 556, 583 (M.D. Pa. 1983), *aff’d sub nom. U.S. v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986), that such statutes of limitations do not apply to governmental entities in actions under federal law.

when it becomes effective between the parties, while a written obligation is incurred upon execution and delivery.

3. The UFTA cleans up and rationalizes the provisions of the UFCA that define how bad a transferor's financial condition must be in order to render a transfer for less than equivalent value susceptible to avoidance on the basis of constructive fraud. For example:

(a) The constructive fraud provisions of both the UFCA and the UFTA apply if the transferor is "insolvent." The definition of the term "insolvent" in the UFCA (§ 2(1)) confusingly includes both language of balance-sheet insolvency ("present fair salable value of [the transferor's] assets") and language suggestive of equity insolvency ("his probable liability on his existing debts as they become absolute and matured"). The UFTA revises the definition to be clearly and unequivocally a balance sheet concept (§ 2(a)). In addition to removing this important ambiguity, the UFTA definition of "insolvent" is very similar to the definition of that term in the Bankruptcy Code (§ 101(32)).

(b) It is notoriously difficult to ascertain (certainly before the fact) whether an entity is "insolvent" in the balance-sheet sense, based on fair valuations, at a given moment. The Bankruptcy Code addresses that difficulty in different ways for different purposes (*e.g.*, § 303(h)(1) [use of equity definition of insolvency for purposes of determining candidacy for involuntary bankruptcy], § 547(f) [for purposes of avoidance of preferences, a debtor is presumed to have been insolvent during the 90 days before the petition], § 553(b) [similar presumption for purposes of applying the setoff-preference provision]). The UFCA does not address this difficulty. The UFTA, by contrast, adds a rebuttable presumption that a transferor who is "not generally paying his debts as they become due" is insolvent in the balance sheet sense (§ 2(b)).

(c) The constructive fraud provisions of both the UFCA and the UFTA also apply if the transferor is insolvent in the equity sense at the time the transferor makes a transfer without receiving fair value in exchange. The UFCA definition of equity-sense insolvency is, however, purely subjective: it applies only if the transferor "intends or believes" that he will incur debts beyond his ability to repay (§ 6). Although this is similar to the definition contained one of the alternative tests set forth in the Bankruptcy Code (§ 548(a)(1)(B)(ii)(III)), it is difficult to see why, as a policy matter, the constructive fraud provisions should not apply to a transfer for less than fair value by an unreasonably optimistic debtor who honestly lacks the requisite intent but who in objective fact cannot reasonably expect to be able to pay his debts. (Indeed, if equity-sense insolvency is defined in a purely subjective way, it is not clear why it is even necessary, as a debtor who makes a transfer for less than fair value knowing that he will not be able to pay his debts would seem likely to have actual intent to defraud his creditors.) The UFTA, like the Bankruptcy Code, rationalizes this provision by providing that a transferor is insolvent in the equity sense if he is unable to pay his debts as they become due, either in his subjective belief or as judged by the standard of objective reasonableness (§ 4(a)(ii)).

4. The UFTA omits the UFCA's provision (§ 8(a)) stating that every transfer from an insolvent partnership to a partner is fraudulent. That provision is unreasonably harsh insofar

as it declares fraudulent a transfer in which the partner gave equivalent value to the partnership in exchange for the transferred property.

5. The “insider preference” rule created by the UFTA (§ 5(b)) provides for heightened scrutiny to transfers to insiders. This rule provides that a transfer is constructively fraudulent, even if reasonably equivalent value is given, where it is made (1) on account of an antecedent debt (2) by an insolvent transferor (3) to an insider who has reasonable cause to believe the transferor is insolvent. There is no analog to this provision in the UFCA (although it may be possible to avoid insider preferences under UFCA by manipulating the “good faith” element of the UFCA’s definition of “fair consideration”).

6. Like the UFCA (§ 7), the UFTA (§ 4(a)(1)) renders avoidable transfers and obligations made “with actual intent to hinder, delay, or defraud” creditors. The UFTA assists courts and parties to transactions in understanding the meaning of “actual intent” by providing (in § 4(b)) a nonexclusive list of eleven factors for courts to consider, namely whether (1) the transfer or obligation was to an insider; (2) the transferor 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 transferor had been sued or threatened with suit; (5) the transfer was of substantially all the transferor’s assets; (6) the transferor absconded; (7) the transferor removed or concealed assets; (8) the value of the consideration received by the transferor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the transferor 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; and (11) the transferor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the transferor. The UFCA provided no such guidance.

7. The UFTA eliminates the distinction in the UFCA (§ 3) between absolute transfers and the granting of a security interest. That distinction may have been meaningful in 1918, but it is not meaningful today.

8. The UFTA eliminates the UFCA provision (§ 3) stating, in effect, that a transfer of property by a person in a state of financial stringency is constructively fraudulent, even though the transferor received reasonably equivalent value in exchange, unless it is also shown that the transferee acted in good faith. This subjective good-faith requirement has been the source of considerable uncertainty.

9. The UFTA expands the remedies available to creditors of a debtor who has committed a fraudulent transfer. It provides (in § 7) that a creditor may (1) avoid the transfer, (2) attach the asset transferred or other property of the transferee or utilize other provisional remedies, (3) enjoin further disposition by the transferor or the transferee, or both, of the asset transferred or of other property, (4) appoint a receiver to take charge of the asset transferred or of other property of the transferee, or (5) be granted any other relief that the circumstances may require. A judgment creditor may also levy execution on the asset transferred or its proceeds.

10. The UFTA clarifies the defenses available to transferees in general and strengthens the defenses available to those who act in good faith (§ 8). If a transfer is fraudulent, the transferee is liable in an amount equal to the lesser of the value of the assets transferred or the

amount of the creditor's claim. A transferee who acts in good faith and takes for reasonably equivalent value has an absolute defense to avoidance of a transfer, and a transferee who takes in good faith is protected, through a lien on the asset transferred or a reduction in liability, to the extent he gave value for the transfer.

### **Matters the Legislature should Consider in Enacting UFTA as New York Law**

The Committees believe that the UFTA is better suited to today's complex business transactions than the aging UFCA presently in force in New York. However, the Committees recommend that, in enacting the UFTA in New York, the Legislature should take into account the following:

1. The Committees recommend that the Legislature alter the two UFTA provisions (§§ 3(b) and 8(e)) providing "safe harbors" from avoidance under §§ 4(a)(2) and 5 by combining them, expanding them to protect regularly conducted, noncollusive execution sales, and narrowing them to exclude from "safe harbor" protection transactions in which an insider is the transferee. The Committees believe that insider transactions deserve fuller scrutiny than arm's length transactions that is not truncated by a "safe harbor" intended for the latter.

2. The Committees recommend that the Legislature give serious consideration to retaining (with necessary conforming changes) existing DCL § 273-a, a non-uniform provision that permits the avoidance by a judgment creditor of a transfer made by its judgment debtor without fair consideration during the pendency of the litigation when the judgment debtor does not satisfy the judgment. This provision essentially substitutes proof of the failure of a judgment debtor to satisfy the judgment for proof of the judgment debtor's insolvency or of actual fraud. This provision has been construed as narrowly focused on aiding judgment creditors by relieving them of the sometimes vexing burden of proving either insolvency or actual fraud, without adverse consequences for legitimate transactions. It has also been criticized as unnecessary because transfers made to place assets beyond the reach of the plaintiff during the pendency of litigation will often be avoidable under the 'actual fraud' test of the UFTA, although perhaps only after risky delay and the incurrence of additional expense.

3. The Committees recommend that the Legislature give serious consideration to retaining (with necessary conforming and modernizing changes) existing DCL § 276-a, a non-uniform provision that requires the court to award attorney's fees to a successful plaintiff in an avoidance action or proceeding in which the debtor and the transferee of the avoided transfer acted with actual intent to hinder, delay or defraud a creditor.

### **Conclusion**

By enacting the UFTA in New York, the Legislature would modernize New York's antiquated fraudulent conveyance laws and make New York law consistent with that of the vast majority of other states and the Bankruptcy Code. The result would be a welcome simplification of the law and an increase in certainty for debtors and creditors. The Committees therefore recommend that the Legislature proceed to enact UFTA in New York (subject to the considerations described above) with all deliberate speed.

Our complete recommendation is set forth in the comparison chart that is annexed to this letter.

We would be glad to answer questions or otherwise assist in this valuable legislative effort. Please do not hesitate to contact [NAME] at [PHONE] if we can be of assistance.