To: Drafting Committee, Advisors and Observers,  
   Amendments to the Uniform Fraudulent Transfer Act  

From: Edwin E. Smith, Chair  
       Kenneth C. Kettering, Reporter  

Date: August 20, 2013  

Re: Developments at and after the Annual Meeting  

This memorandum sets forth matters that came to our attention at or after the ULC’s Annual Meeting in July and that we believe should be brought to the attention of the addressees.

Draft language may be of use in considering two of the topics of this memorandum. Accordingly, draft language relating to those topics is included in Annexes A and B to this memorandum. We think that this form of presentation will be more useful for the Drafting Committee than would preparation of a complete new draft of the amendment package. Accordingly, the draft of the amendment package to be discussed at the September meeting will be the Annual Meeting Draft (dated May 31, 2013), together with the alternative provisions set forth in the annexes to this memorandum. Citations in this memorandum are to the Annual Meeting Draft unless otherwise indicated.

Circulated contemporaneously with this memorandum is the transcript of proceedings at the Annual Meeting that relate to this project. This memorandum does not attempt to summarize those proceedings.

1. The definition of “insider.” In the UFTA, the term “insider” (together with the terms “affiliate” and “relative,” which are used only in the definition of “insider”) defines the scope of section 5(b), the insider preference provision. The definition of “insider” in section 1(8) of the Annual Meeting Draft is unaltered from the original 1984 text, except for its numbering. It provides specific guidance as to who constitutes an “insider” only for a debtor that is an individual, corporation or partnership. At the Annual Meeting David Walker, a commissioner from Iowa who has been prominent in various ULC projects (e.g., chair of the committee that drafted the Revised Uniform Limited Liability Company Act), suggested that the Drafting Committee consider revising the definition in order to provide specific guidance in respect of a debtor that is a limited liability company or that is organized in some more exotic form.

After the Annual Meeting, reporter Kettering studied the suggestion and prepared a memorandum on the subject to chairman Smith and Dan Kleinberger, advisor to the Drafting Committee representing the ABA Business Law Section who has special expertise in business organizations. The memorandum recommended that the statutory text not be changed (aside from correction of a couple of typos in the definition of “affiliate”), and that the comment be elaborated. Smith and Kleinberger agreed with that recommendation.

Annex A to this memorandum sets forth draft language that would implement that recommendation. Specifically, the language makes two typographical corrections to the definition of “affiliate” and revises the comment to the definition of “insider.”
Accompanying this memorandum is a copy of Kettering’s memorandum to Smith and Kleinberger, dated July 23, 2013 (revised August 8, 2013), together with copies of two items referred to therein, as follows: (i) a blacklined and annotated copy of the definitions of “insider,” “affiliate” and “relative” as they appear in the UFTA and the Bankruptcy Code, and (ii) a copy of *In re Longview Aluminum, L.L.C.*, 657 F.3d 507 (7th Cir. 2011).

2. The § 8(e)(2) defense to constructive fraud attack for exercise of Article 9 remedies: applicability to strict foreclosure. Section 8(e)(2) exempts from constructive fraud attack “enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code.” As noted at a previous meeting of the Drafting Committee, at least three important commercial states, California, Connecticut, and Pennsylvania, modified their enactments of the UFTA to carve out from this exemption the Article 9 remedy of strict foreclosure (that is, acceptance of collateral by the secured party in full or partial satisfaction of the obligation secured by the collateral). The Drafting Committee has previously dismissed proposals to amend the official text to do likewise, but that decision was grounded at least in part on the thought that the Drafting Committee’s mandate did not extend to making such a change.

In July, the Scope and Program Committee expanded the mandate of the Drafting Committee to include this issue. Accordingly, the Drafting Committee is now in a position to consider the issue entirely on its merits.

Annex B to this memorandum sets forth for discussion purposes draft language that would implement such a change. The language comprises an amendment to Section 8(e)(2) and the official comment thereto.

A note on the drafting of Annex B. The effect of UFTA § 8(e)(2) partly duplicates that of UFTA § 3(b). Section 3(b), which relates to the definition of “value,” has the effect of immunizing an Article 9 foreclosure sale from constructive fraud attack (provided that the foreclosure sale is “regularly conducted” and “noncollusive”). In addition, section 3(b) similarly immunizes foreclosure sales under real estate mortgages and deeds of trust. California, Connecticut and Pennsylvania each chose to immunize Article 9 foreclosure sales from constructive fraud attack, but not to immunize Article 9 strict foreclosure, and because of the overlap between the two cited provisions the three states took very different drafting approaches. California deleted § 3(b) and folded its substance into § 8(e)(2), adding a carve-out for strict foreclosure. Pennsylvania retained both § 3(b) and § 8(e)(2) but added to § 8(e)(2) a carve-out for strict foreclosure. Connecticut simply deleted § 8(e)(2). Observe that § 8(e)(2) immunizes all Article 9 remedies from constructive fraud attack, which includes the remedy of collection of receivables (UCC §§ 9-607 and 9-608) as well as the remedies of foreclosure sale (UCC § 9-610) and of strict foreclosure (UCC §§ 9-620 through 9-622). Connecticut’s deletion of § 8(e)(2) thus removed the immunity for collection of receivables as well as for strict foreclosure. Annex B takes the same drafting approach as did Pennsylvania.

It should also be noted that strict foreclosure of a real estate mortgage is not exempted from constructive fraud attack. The exemption in § 8(e)(2) applies only to remedies under Article 9, and the exemption effectively provided by § 3(b) does not apply to strict foreclosure because that is neither a “foreclosure sale” nor an “execution of a power of sale.” A few states
presently provide for strict foreclosure in real estate transactions. That remedy may become more widespread in the future, for the proposed uniform law on foreclosure of home mortgages that is presently being drafted contains provisions allowing strict foreclosure that are patterned on those of Article 9. Uniform Home Foreclosure Procedures Act §§ 501-504 (Annual Meeting Draft, June 4, 2013).

3. **Liberal construction and other remedial suggestions.** Harry Tindall, a commissioner from Texas who has been prominent in various ULC projects (e.g., chair of the committee that drafted the Uniform Parentage Act), submitted written comments on the Annual Meeting Draft after the Annual Meeting. Among them was the following:

[I] suggest that this act contain three additional provisions:
1. Statute is to be liberally construed to effectuate its remedial purpose,
2. The act should allow for attorney’s fees, and
3. Allowance for punitive damage in appropriate cases.

The Drafting Committee has previously discussed and rejected point 2, relating to attorney’s fees.

The Drafting Committee has not previously discussed point 3, relating to punitive damage. However, allowance of punitive damages would not seem consistent with rejection of a provision allowing attorney’s fees. It may be noted that courts in some jurisdictions have awarded punitive damages under UFTA despite the statutory silence. Such an award might be based on section 7(a)(iii), which authorizes “any other relief the circumstances may require,” or section 11, which provides that “the principles of law and equity” supplement the provisions of the UFTA unless displaced by the provisions of the UFTA. Not surprisingly, however, other courts have concluded that they lack power to award punitive damages due to the absence of express reference in the UFTA. Writing in 2010, the Wisconsin Court of Appeals held that a trial court lacked power to grant punitive damages under UFTA, at least in a case in which compensatory monetary damages had not been awarded. As to the law in other jurisdictions, the court said:

[The plaintiff] urges us to look to the law of other states that have enacted the Uniform Fraudulent Transfers Act and have construed it to allow recovery of punitive damages….

However, the out-of-state cases cited by [the plaintiff] are not particularly helpful. As [the plaintiff] itself points out, the eight states that have addressed the availability of punitive damages under the Act are split on the issue. Although six states allow punitive damages, two do not. Resolution of the issue in each state depends on that state’s underlying law on the availability of punitive damages. Thus, the law in this area is not currently uniform, and is unlikely ever to become uniform under the current version of the Act, in which punitive damages are not specifically addressed.


The Drafting Committee has not previously considered point 1, *i.e.*, the advisability of adding a provision directing that the Act be liberally construed. Such a provision is a fairly
common feature of uniform laws, appearing in fifteen of those currently in *Uniform Laws Annotated.* In almost all of these uniform laws, the provision stating a policy of liberal construction also states a policy of construction to promote uniformity. See, *e.g.*, UCC § 1-103(a). UFTA § 12 presently states a policy of construction to promote uniformity. So the question can be rephrased as: should UFTA § 12 be amended to state a policy of liberal construction, as well as the policy of construction to promote uniformity?

Commissioner Tindall did not cite any specific situation in which the adoption of this suggestion would have made a difference. Moreover, it might be thought that there is more need for such a provision in a long and complex statute than in the relatively short and simple UFTA. Furthermore, such provisions invariably include a statement of the purpose of the statute, the promotion of which is the goal of the “liberal construction.” Many such provisions contain fairly lengthy and detailed recitations of the purposes of the uniform law, which the UFTA presently lacks. Commissioner Tindall suggested simply that the UFTA provision state that the act is to be “liberally construed to effectuate its remedial purpose.” Such a provision might discourage the award of punitive damages and perhaps even attorney’s fees, as such awards arguably are not “remedial.”

4. **Name of the Act.** Comments from the floor of the Annual Meeting were about evenly divided on the desirability of changing the name of the Act. As a matter of interest, Commissioner Tindall’s written comments included the statement that he “strongly supported” changing the name of the Act to “Uniform Voidable Transfer Act.”

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Annex A

“Insider” and Related Definitions
Marked to show changes from the 1984 Official Text

SECTION 1. DEFINITIONS. As used in this [Act]:

(1) “Affiliate” means:

(i) a person who directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole discretionary power to vote the securities; or

(B) solely to secure a debt, if the person has not in fact exercised the power to vote;

(ii) a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor or a person who directly or indirectly owns, controls, or holds, with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole discretionary power to vote the securities; or

(B) solely to secure a debt, if the person has not in fact exercised the power to vote;

(iii) a person whose business is operated by the debtor under a lease or other agreement, or a person substantially all of whose assets are controlled by the debtor; or

(iv) a person who operates the debtor’s business under a lease or other agreement or controls substantially all of the debtor’s assets.
Official Comment

(7) (8) The definition of “insider” is derived from Bankruptcy Code § 101(28) (1984) of the Bankruptcy Code. The definition has been restricted in clauses (i)(C), (ii)(E), and (iii)(D) to make clear that a partner is not an insider of an individual, corporation, or partnership if any of these latter three persons is only a limited partner. The definition of “insider” in the Bankruptcy Code does not purport to make a limited partner an insider of the partners or of the partnership with which the limited partner is associated, but it is susceptible of a contrary interpretation and one which would extend unduly the scope of the defined relationship when the limited partner is not a person in control of the partnership. The definition of “insider” in this Act also differs from the definition in the Bankruptcy Code in omitting the reference in 11 U.S.C. § 101(28)(D) to an elected official or relative of such an official as an insider of a municipality. As in the Bankruptcy Code (see 11 U.S.C. § 102(3)), the word “includes” is not limiting, however. Thus, a court may find a person living with an individual for an extended time in the same household or as a permanent companion to have the kind of close relationship intended to be covered by the term “insider.” Likewise, a trust may be found to be an insider of a beneficiary.

The definition of “insider” states that the term “includes” certain listed persons; it does not state that the term “means” the listed persons. Hence the definition in this Act, as in the Bankruptcy Code § 102(3) (1984). Accordingly, a person may be an “insider” of a debtor that is an individual, corporation or partnership even though the person is not designated as such by the statutory list. Thus, for example, a court may find a person living with an individual debtor for an extended time in the same household or as a permanent companion to have the kind of close relationship intended to be covered by the term “insider.” See also, e.g., Browning Interests v. Allison (In re Holloway), 955 F.2d 1008 (5th Cir.1992) (former spouse of debtor was an “insider” because of their continued personal relationship, even though they had long ago divorced and remarried others). Likewise, a person may be an “insider” of a debtor that is not an individual, corporation or partnership. See, e.g., In re Longview Aluminum, L.L.C., 657 F.3d 507 (7th Cir. 2011) (holding an “insider” of a limited liability company an individual on its Board of Managers and having a 12% membership interest, when its organic documents vested management authority “in the Board of Managers and the Members”).

[End of Annex A]
Annex B
Section 8(e)(2) defense: carveout for strict foreclosure
Marked to show changes from the 1984 Official Text

SECTION 8. DEFENSES, LIABILITY, AND PROTECTION OF TRANSFEREE.

* * *

(e) A transfer is not voidable under Section 4(a)(2) or Section 5 if the transfer results from:

(1) termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law; or

(2) enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code, other than acceptance of collateral in full or partial satisfaction of the obligations it secures.

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Official Comment

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(5) Subsection (e)(1) rejects the rule adopted in Darby v. Atkinson (In re Farris), 415 F.Supp. 33, 39-41 (W.D.Okla. 1976), that termination of a lease on default in accordance with its terms and applicable law may constitute a fraudulent voidable transfer. Subsection (e)(2) protects a transferee who acquires a debtor’s interest in an asset as a result of the enforcement of a secured creditor’s party’s rights pursuant to and in compliance with the provisions of Part 6 of Article 9 of the Uniform Commercial Code. Cf. Calaiaro v. Pittsburgh Nat’l Bank (In re Ewing), 33 B.R. 288, 9 C.B.C.2d 526, CCH B.L.R. ¶ 69,460 (Bankr. W.D.Pa. 1983) (foreclosure sale of pledged stock held subject to avoidance as fraudulent transfer in § 548 of the Bankruptcy Code), rev’d, 36 B.R. 476 (W.D.Pa. 1984) (transfer held not voidable because deemed to have occurred more than one year before bankruptcy petition filed). Although a secured creditor may enforce rights in collateral without a sale under § 9-502 or § 9-505 of the Code, the creditor must proceed in good faith (U.C.C. § 9-103) and in a “commercially reasonable” manner. The “commercially reasonable” constraint is explicit in U.C.C. § 9-502(2) and is implicit in § 9-505. See 2 G. Gilmore, Security Interests in Personal Property 1224-27 (1965). Article 9’s global requirement that the secured party enforce its rights in good faith, and further requirement that certain remedies be conducted in a commercially reasonable manner, provide substantial protection to the other creditors of the debtor. See U.C.C. §§ 1-304, 9-607(b), 9-610(b) (2014). The exemption afforded by subsection (e)(2) does not extend to acceptance of collateral in full or
partial satisfaction of the obligations it secures. That remedy, contemplated by U.C.C. §§ 9-620–
9-622 (2014), is sometimes referred to as “strict foreclosure.” An exemption for strict
foreclosure would be inappropriate because a strict foreclosure complying with Article 9 could
be the functional equivalent of a voluntary conveyance of the collateral by the debtor to the
secured party.

[End of Annex B]