

HOUSE BILL REPORT

SB 5085

As Passed House:
April 7, 2017

Title: An act relating to enactment of the uniform voidable transactions act.

Brief Description: Enacting the uniform voidable transactions act.

Sponsors: Senators Pedersen, Padden, Frockt and O'Ban; by request of Uniform Law Commission.

Brief History:

Committee Activity:

Judiciary: 3/14/17, 3/22/17 [DP].

Floor Activity:

Passed House: 4/7/17, 95-1.

Brief Summary of Bill

- Adopts the Uniform Law Commission amendments to the Uniform Fraudulent Transfer Act, including changing the title to the Uniform Voidable Transactions Act.
- Adds provisions regarding choice of law and evidentiary matters, such as burden of proof.
- Removes the special definition of "insolvency" for partnerships.
- Addresses the treatment of "series organizations," a new type of business entity which cannot currently be formed under Washington law.
- Includes two non-uniform amendments: (1) defining "reasonably equivalent value;" and (2) slightly broadening the defenses available to a good faith transferee.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 13 members: Representatives Jinkins, Chair; Kilduff, Vice Chair; Rodne, Ranking Minority Member; Muri, Assistant Ranking Minority Member; Frame, Goodman, Graves, Haler, Hansen, Kirby, Klippert, Orwall and Shea.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Staff: Audrey Frey (786-7289).

Background:

The Uniform Voidable Transactions Act (UVTA) is a 2014 Uniform Law Commission (ULC) update to the Uniform Fraudulent Transfer Act (UFTA), which was drafted by the ULC in 1984 and enacted by Washington in 1987. The UFTA has been enacted by 45 states and jurisdictions including the District of Columbia, and the United States Virgin Islands. (The ULC is composed of state commissions on uniform laws. The purpose of the ULC is to determine which areas of law should be made uniform, and to promote uniformity by drafting and proposing uniform statutes. States decide whether to enact a uniform law or not.) The UFTA replaced the earlier Uniform Fraudulent Conveyances Act, which was drafted by the ULC in 1918 and enacted by Washington in 1945.

The Uniform Fraudulent Transfer Act, as Enacted in Chapter 19.40 RCW.

The UFTA discourages fraudulent transfers made by a debtor to harm a creditor's interest in property by providing remedies that allow a creditor to avoid a fraudulent transfer. The UFTA defines a fraudulent transaction as a transfer of property or an obligation incurred with the intent to hinder, delay, or defraud creditors. Transfers without adequate consideration are generally fraudulent if the debtor is or becomes insolvent, knows he or she cannot pay his or her debts, or is left with insufficient assets to conduct his or her business. In determining fraud, the adequacy of consideration depends on whether a reasonably equivalent value is received in the transfer.

Certain defenses are provided to protect good faith transferees and obligees against actions by a creditor. A transfer or obligation is generally not voidable against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee. If a creditor is subject to a fraudulent transfer and none of the defenses apply, a creditor may: (1) obtain avoidance of the transfer or obligation; (2) obtain attachment of the asset transferred or other property of the transferee; or (3) obtain an injunction, appoint a receiver, or receive other equitable remedies. The statute of limitations ranges from one to four years, depending on the type of fraudulent transfer.

The Uniform Voidable Transactions Act, as Promulgated by the Uniform Law Commission.

The UVTA is the first ULC update to the UFTA since its creation in 1984. The UVTA amendments are not a comprehensive revision of the UFTA, but they address a number of issues, including: (1) changing the title from UFTA to UVTA, in response to confusion regarding the use of "fraudulent" in the original title: fraud is not, and never has been, a necessary element of a claim for relief under the UVTA; (2) adding choice of law provisions; (3) adding provisions regarding evidentiary matters such as burden and standard of proof; (4) removing the special definition of "insolvency" for partnerships; (5) rewording provisions relating to defenses available to a transferee or obligee; (6) adding a new section regarding "series organizations;" (7) replacing references to "writing" with references to "record," in response to changes in technology; and (8) making various other stylistic changes. So far, 10 states have enacted the UVTA amendments.

Summary of Bill:

The Uniform Voidable Transactions Act (UVTA) amendments are adopted in chapter 19.40 RCW, along with two non-uniform amendments, or amendments that do not appear in the version of the UVTA as promulgated by the Uniform Law Commission. The two non-uniform amendments: (1) define "reasonably equivalent value" as market value; and (2) slightly broaden the defenses available to a good faith transferee or obligee against an action by a creditor.

Choice of Law.

A new section is added setting forth a choice of law rule applicable to claims for relief governed by the UVTA. A claim for relief under the UVTA is governed by the local substantive law of the jurisdiction in which the debtor is "located" at the time the challenged transfer is made or the challenged obligation is incurred. "Location" is defined separately for individuals, organizations with one place of business, and organizations with more than one place of business.

Evidentiary Matters.

New provisions regarding burden of proof are added to several sections:

- Under the insolvency section, a debtor that is generally not paying debts as they become due, other than as a result of a bona fide dispute, is presumed to be insolvent, and the debtor has the burden of proving that the nonexistence of insolvency is more probable than its existence.
- Under the sections regarding transfers that are voidable as to present and future creditors, the creditor has the burden of proving the elements of the claim for relief by a preponderance of the evidence.
- Under the section regarding defenses, liability, and protection of transferees, rules allocating the burden of proof are provided for each subsection, and the standard of proof is preponderance of the evidence.

Deletion of the Special Definition of "Insolvency" for Partnerships.

The special definition of "insolvency" for partnerships, requiring that the net worth of a general partner be included in determining the insolvency of a partnership, is removed. In effect, the general definition of "insolvency," which states that a debtor is insolvent if a fair valuation of the sum of the debtor's debts is greater than the sum of the debtor's assets, now applies to partnerships.

Defenses.

Several provisions relating to defenses available to a transferee or obligee are modified:

- The subsection regarding subsequent transferees is reworded for clarity.
- The subsection regarding a defense for transfers resulting from enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code is modified to exclude situations where collateral is accepted in full or partial satisfaction of the obligation it secures.
- The complete defense available to a good faith transferee or obligee against an action by a creditor is slightly broadened by adding a clause that allows a good faith transferee or obligee to argue a defense regardless of whether they made the transfer to the debtor or to someone else. (This is a non-uniform amendment.)

Series Organizations.

A new section is added providing that a "series organization" and each "protected series" of a series organization is to be treated as a separate person for purposes of the UVTA, even if not treated as a separate person for other purposes.

Washington law does not currently provide for formation of series organizations, but a number of other states and jurisdictions have legislation enabling the creation of these type of organizations. This section will apply if a series organization or protected series organized under the law of a different state makes a transfer to another protected series of that organization and the voidability of the transfer is governed by Washington law.

A "series organization" is a type of business organization that, pursuant to the law under which it is organized, has the following characteristics: (1) the organization's organic record (e.g. Articles of Incorporation and any amendments) provide for creation of one or more protected series with respect to specified property of the organization, and for records to be maintained for each protected series identifying its property; (2) debt incurred or existing with respect to the activities or property of a particular protected series is enforceable only against the property of that series, and not against the property of other protected series of the organization or the organization as a whole; and (3) debt incurred or existing with respect to the activities or property of the organization is enforceable only against the property of the organization, and not against the property of a protected series of the organization.

Definitions.

Certain definitions are added or modified:

- The terms "electronic," "organization," "record," and "sign" are added.
- The definition of "affiliate," "claim," and "person" are slightly modified.
- "Reasonably equivalent value" is defined as market value: a transfer or an obligation that is within the range of values for which the transferor would have sold the property or services to, or purchased the property or services from, the transferee in an arm's length transaction at market rates. (This is a non-uniform amendment.)

Other Provisions and Modifications.

Replacing References to "Writing." References to the term "writing" are replaced with the term "record" in order to accommodate changes in technology.

Changing References to "Fraudulent." References to the term "fraudulent" are replaced with the term "voidable" throughout the chapter, with the effect that the phrase "voidable transfer" now consistently denotes the type of transfer for which the UVTA provides a remedy.

Relation to the Federal Electronic Signatures in Global and National Commerce Act. The UVTA modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act (ESGNCA), except as it pertains to electronic delivery of certain notices. This section responds to specific language in the ESGNCA that authorizes state statutes to modify, limit, or supersede certain provisions of the ESGNCA as long as certain requirements are satisfied, and is designed to avoid preemption of state law under that federal legislation.

Short Title. This chapter, which was formerly cited as the Uniform Fraudulent Transfer Act, may be cited as the UVTA.

Effect on Prior Transfers and Obligations. The UVTA applies to a transfer made or obligation incurred on or after the effective date of this section, but does not apply to a transfer made, obligation incurred, or right of action that has accrued before the effective date of this section.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This is the last request bill for this year from the Uniform Law Commission (ULC). The bar association's debtor and creditor section took a good look at this and suggested the retention of the two non-uniform provisions.

The Washington State Bar Association Creditor Debtor Section supports the enactment of the Uniform Voidable Transactions Act (UVTA) with the two non-uniform provisions that have been incorporated into this bill. The purpose of fraudulent transfer law is to provide a remedy for creditors in situations where the debtor transfers property with intent to hinder, delay, or defraud creditors. The problem has been around for a very long time, and fraudulent transfer law has been around a very long time. This area of the law tries to balance the goal of providing remedies for the creditor with the goal of providing a defense for transferees who did no wrong.

Currently, Washington has enacted the Uniform Fraudulent Transfer Act (UFTA). In 2014 the Uniform Law Commission approved an amended version known as the UVTA. The most significant change is the substitute of the phrase "voidable transaction" for the phrase "fraudulent transfer." This is a positive change and improves and clarifies the law.

Fraud is an offense that requires nine elements of proof and a very high evidentiary burden—clear and convincing evidence. The fraudulent transfer statute applies not just to fraud, but to any transfer of property made by a debtor who intends to hinder, delay, or defraud creditors. The statute also applies to transfers of property made by a financially distressed debtor who transfers property but receives less than reasonably equivalent value in exchange. Fraud is not an essential element of a fraudulent transfer case. The word "fraudulent" in the title is misleading and causes confusion for judges unnecessary distress for defendants. The phrase "voidable transaction" is a much more accurate description.

The UVTA also makes explicit that the burden of proof is not the clear and convincing evidence required in a civil fraud case; the burden of proof is the much more standard preponderance of the evidence.

The two non-uniform provisions that the creditor debtor section recommends are an improvement to the version recommended by the ULC. The ULC version provides a narrow

defense to defendant transferees who, in exchange for the transfer of property by the debtor, gave reasonably equivalent value to the debtor. This defense is too narrow because it excludes transferees who gave value to someone other than the debtor.

For example, in the case of universities, parents often pay the tuition for their children, and some years later, parents may file for bankruptcy or get into financial trouble. The bankruptcy trustees in these cases are suing the universities to recover the tuition payments. Under the UVTA as promulgated by the ULC, the trustee would win and the universities would lose because the universities provide education to the child. The universities do not give anything of value to the parent transferor. This is a mistake. The universities do no wrong. They provide education in exchange for tuition payments, and they should not have to pay money to the bankruptcy trustees or the creditors of the debtor.

Another example arose in the bankruptcy court of the Western District of Washington. This case involved an elderly couple who put their house on the open market. They sold their house to the man who made the best offer. They did not know him, but he was brought to them by the broker. This man owned several businesses, and one of them was a Limited Liability Corporation (LLC). He used the LLC to wire-transfer payments to the escrow company that closed the transaction. After some time it was learned that this man ran a Ponzi scheme, and he is currently serving an 18-year sentence in a federal penitentiary for criminal fraud. His financial affairs, and the financial affairs of his companies, were wound-up by bankruptcy trustees. In the process of this winding-up, the bankruptcy trustee saw that the LLC had wired funds to an escrow account and sued the elderly couple alleging that they had received a fraudulent transfer. The elderly couple lost: the court ruled that because the elderly couple had deeded the house to the man who ran the Ponzi scheme, but the money came from the LLC, the elderly couple had to pay the LLC's bankruptcy trustee. The law should not punish innocent people like this couple.

This bill corrects the problem by providing a defense to a good faith transferee who gives reasonably equivalent value in exchange, whether or not the value goes to the debtor/transferor. The other non-uniform recommendation is to include a definition of "reasonably equivalent value."

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; and Bruce Borrus, Washington State Bar Association.

Persons Signed In To Testify But Not Testifying: None.