Alabama Uniform Voidable Transactions Act

Chris Glenos and Cathy Moore

Bradley

Enactment of "AUVTA"

- Alabama is the 17th state to enact the UVTA
- Effective Date: January 1, 2019:
- AUVTA replaces the Alabama Uniform Fraudulent Transfer Act ("AUFTA") and applies to all transfers and transactions occurring after January 1, 2019 (AUFTA applies to transactions before 1/1/19)
- AUVTA is not a wholesale rewriting of the AUFTA
- Changes are narrow, targeted, and intended to clarify points of confusion and harmonize law with other statutes

Summary of Changes to the AUFTA

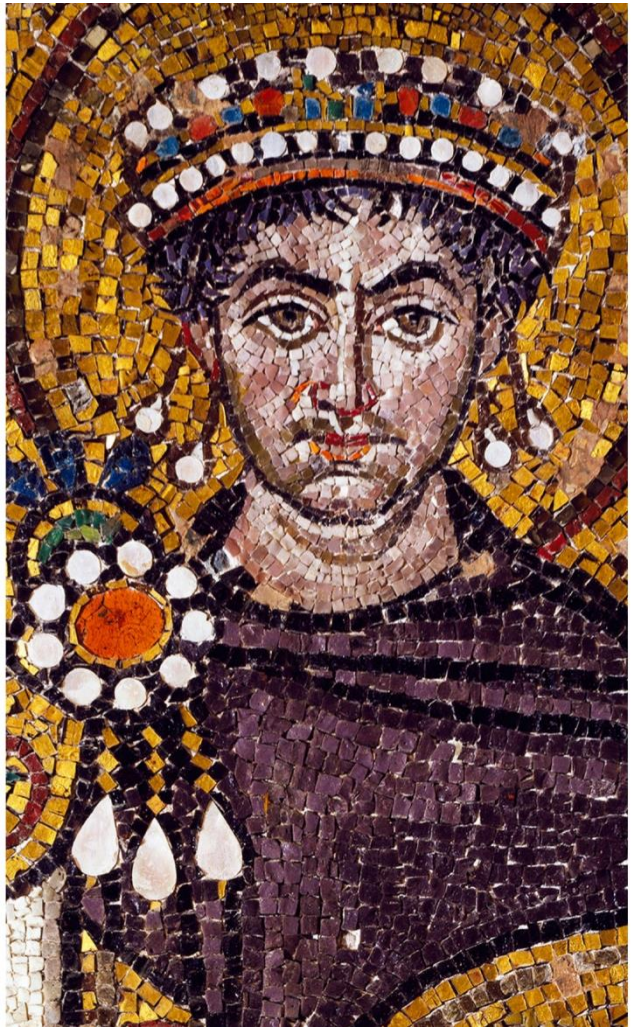
1. Changes to Verbiage
2. Adds Choice of Law Provision
3. Adds Burden Proof Provision
4. Refines the Definition of Insolvency
5. Refines Certain Defenses
6. Addresses Series Organizations

Overview of AUFTA/AUVTA

Four general types of transactions are voidable under both the AUFTA and the AUVTA:

- Transfers made with actual intent to hinder, delay, or defraud creditors;
- Transfers made by an insolvent debtor without receiving reasonably equivalent value in exchange for the transfer;
- Transfers made by an insolvent debtor to an insider of the debtor that has reasonable cause to believe that the debtor is insolvent; and
- Transfers made by a debtor, without receiving reasonably equivalent value in exchange for the transfer, when the debtor is either undercapitalized or about to incur debts beyond his ability to pay as they become due.

The changes in the AUVTA are relatively minor, yet so important, because they are intended to clear up centuries of confusion. To understand why, we'll begin with a short history lesson . . .



Byzantine Emperor Justinian and Queen Elizabeth I

A brief history of fraudulent transfer law

As long as there has been property, there have been defaulting debtors trying to evade creditors.

- The ancient Romans had a well-developed body of fraudulent transfer law.
- The Institutes of Justinian, compiled by Byzantine Emperor Justinian I, included this statement of fraudulent transfer law:

“Again, if any one has transferred his property to another in fraud of creditors, upon judgment to that effect by the chief provincial magistrate, the creditors of the transferor may seize his property, avoid the transfer, and recover the thing transferred, that is, they may claim that the things have not been transferred at all and accordingly are still within the legal possession of the debtor.”

- Institutes of Justinian, 4, 6, 6

This core statement of fraudulent transfer law remains remarkably unchanged from when it was first published in 533 A.D.

A brief history of fraudulent transfer law

- Roman law, as published in the Justinian writings, was likely carried over to England during the missions of St. Augustine during the late 5th century A.D.
- Roman law continued to influence the development of the English common law in the centuries that followed.
- But the English courts did not always acknowledge their use and applications of Roman law.
- There was a hostility to “foreign laws” generally, and Roman law in particular, that resulted in a rejection of Roman law – at least openly.

A brief history of fraudulent transfer law

- By the 1500s, during the reign of Queen Elizabeth I, England's stature as a mercantile power grew, and its lack of a written statutory code became unworkable.
- In developing its own statutory code, the English drew heavily from the Romans, but wanted to maintain plausible deniability that they were doing so.
- So sometimes they would change the legal terms, and sometimes important meaning got lost in translation. Such is the case with fraudulent transfer law.

A brief history of fraudulent transfer law

- English fraudulent transfer law incorporated the Roman concept embodied in the Latin phrase "*in fraudem creditorum*," or "in fraud of creditors."
- *In fraudem creditorum*, properly translated, means something roughly equivalent to "to the disadvantage of creditors."
- But as translated by the English, it came to mean something more akin to "in deceit of creditors" suggesting an intent element of intentional fraud or misrepresentation.

A brief history of fraudulent transfer law

When the English Fraudulent Conveyances Act of 1571 (Statute of 13 Elizabeth C. 5) was carried across the Atlantic to the American colonies, its misleading focus on “deceit” instead of “disadvantage” came too, and centuries of confusion followed.

(But why does that matter? . . . .)

Problems caused by faulty translation

- With the concept of deceit or intentional misrepresentation unwittingly baked into the name “fraudulent transfer” from the beginning, courts regularly misapplied the laws in a variety of contexts:

Problems caused by faulty translation

Pleading standards:

- Some courts required plaintiffs to specifically plead “fraudulent intent” when alleging a fraudulent transfer because of the federal and state rules of procedure requiring parties to plead “fraud” with particularity.

- Even though fraudulent transfers are unrelated to “fraud,” and fraud is not an element of a claim under the UFTA, courts would dismiss otherwise valid fraudulent transfer claims for failure to meet the heightened pleading standard for “fraud.”

Problems caused by faulty translation

Suggestion of a (non-existent) intent element:

- Under several theories of recovery for fraudulent transfers, there is no intent element at all, much less a required showing of “fraudulent” intent.
- For example, under the UAFTA, creditors may avoid transfers made without adequate consideration if (1) the debtor was left with unreasonably small assets for a transaction or business in which the debtor was about to engage; the debtor incurred more debts than the debtor would be able to pay as they came due; or (3) the debtor was insolvent at the time of the transfer.
- These theories of recovery have nothing to do with fraud, or intent of any sort, yet came to be known by the oxymoronic “constructive fraud.”

Problems caused by faulty translation

Skewed intent element:

- Even under theory of recovery relating to a transfer of property made by a debtor with “actual intent to hinder, delay, or defraud” a creditor, the “fraud” tag can distort results.

- This section applies even if the debtor intends to merely “hinder” or “delay” a creditor, even absent intent to defraud, yet this section came to be widely known as “actual fraud” which is misleading, because the provision does not, in fact, require proof of fraudulent intent.

Name change was major priority for drafting committee of Uniform Law Commission

"[T]he retitling is not motivated by the substantive revisions to the 2014 amendments, which are relatively minor. Rather the word "Fraudulent" in the original title, though sanctioned by historical usage, was a misleading description of the Act as it was originally written. Fraud is not, and never has been a necessary element of a claim for relief under the Act. The misleading intimation to the contrary in the original title of the Act led to confusion in the courts."

To recap: 4 general types of transactions are voidable under both the AUFTA and the AUVTA

- Transfers made with actual intent to hinder, delay, or defraud creditors;
- Transfers made by an insolvent debtor without receiving reasonably equivalent value in exchange for the transfer;
- Transfers made by an insolvent debtor to an insider of the debtor that has reasonable cause to believe that the debtor is insolvent; and
- Transfers made by a debtor, without receiving reasonably equivalent value in exchange for the transfer, when the debtor is either undercapitalized or about to incur debts beyond his ability to pay as they become due.

AUVTA Changes

(1) Changes in verbiage

AUFTA	AUVTA
• "***Fraudulent***"	• "***Voidable***"
• "***Transfers***"	• "***Transactions***"

"Voidable" intended to discourage application of erroneous intent element by courts and parties

"Transfer" was considered underinclusive because it failed to cover the incurrence of obligations by the debtor, which are also covered by the AUVTA

(2) Choice of Law

- AUVTA Claims are governed by the law of the jurisdiction in which debtor is “located” at time of the transfer
- “Located”:
  - **Individual:** principal residence
  - **Organization:** its place of business
  - **Organization with more than one POB**: chief executive office
- Analogous to section 9-301 of UCC
- Simple, predictable rule; discourages forum shopping

(3) Burden of Proof

- Generally, the creditor has burden of proving AUVTA claims
- Generally, the transferee has burden of proving AUVTA defenses
- Standard of Proof: simple "***preponderance of evidence***" standard
- AUVTA rejects heightened "clear and convincing evidence" standard, even if "actual intent to defraud" is alleged

(4) Insolvency

- Debtor is insolvent "*if the sum of debtor's debts* ***at fair valuation*** *is greater than the sum of debtor's assets at fair valuation*"
- Special definition of insolvency for partnerships is DELETED
- Presumption of Insolvency: A debtor who is generally not paying debts as they come due is ***presumed*** insolvent
- If the presumption is triggered, the burden shifts to defendant (i.e., transferee) to prove Debtor was solvent

(5) Refinement of Defenses

- **Under Section 8(a) Good Faith/REV are a Complete Defense to claim based on "actual intent" provided the REV goes to the Debtor**
  - AUFTA made it a complete defense to so-called "actual fraud" (transfers made with actual intent to hinder, delay, defraud creditors) if the transferee takes in good faith and for reasonably equivalent value
  - AUVTA clarifies that the reasonably equivalent value must be given ***<u>to the debtor</u>***

(5) Refinement of Defenses

- **Additional protection for "Subsequent Transferees" Under Section 8 (b) of the AUVTA**
  - AUVTA retains AUFTA's complete defense for subsequent transferees (i.e., transferees other than the first transferee) that take in good faith and for value
  - Section 8(b) AUVTA also protects any subsequent transferee who takes in good faith from a ***protected*** transferee, ***even if the subsequent transferee did not take for value***

(5) Refinement of Defenses

- **AUVTA excludes "strict foreclosure" from the safe harbor for Article 9 remedies**
  - AUVTA retains AUFTA "safe harbor" language providing that transfers resulting from enforcement of a security interest under article 9 or a non-collusive mortgage foreclosures are <u>not</u> avoidable.
  - AUVTA carves out "acceptance of collateral in full or partial satisfaction of the obligation it secures" under Article 9- aka "strict foreclosure."

(6) Series Organizations

- AUVTA adds new section providing that a “series organization” and each “series of the organization” is to be treated as a separate person for purposes of the Act, even if not treated as a person for other purposes.
- Recognition of the increasing prevalence of series organizations in complex transactions
- Series organization may not be a legal entity, even though it has own assets and liabilities, and if not legal entity, creditor could not challenge a transfer of property from one series to another under fraudulent transfer law, which applies only to a “person” (i.e., a legal entity)
- AUVTA seeks to close this loophole by treating “series” as a person

Significant Alabama Deviations from the UVTA

- Alabama adopted the UVTA in large measure, with a couple of notable exceptions:
  - First, ***retained*** existing ***statute of limitations***
  - Second, as with UAFTA, UAVTA omitted language referring to "***obligations***," opting instead to leave the questions of whether an obligation is void as voidable conveyance to existing common law.

Chris Glenos is a Partner at Bradley, and chairs its Bankruptcy & Creditors' Rights practice group. Chris represents creditor clients in commercial litigation, fraudulent transfer and preference actions, contested bankruptcy matters, lender liability claims, commercial foreclosures, executions, replevin actions and prejudgment seizures. Chris served as a member of the Alabama Law Institute's Committee on the Uniform Voidable Transactions Act.

Cathy Moore is Counsel in the Bankruptcy & Creditors' Rights practice group at Bradley. Cathy represents debtors, creditors, purchasers of distressed assets, and other clients in Chapter 11 bankruptcy cases, out of court restructurings, and complex commercial litigation matters in state, federal, and bankruptcy courts. Cathy currently serves on the Board of the Alabama State Bar Bankruptcy & Commercial Law Section.

Bradley