Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #329

Date: 25-Aug-16
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: Ken Kettering & Ed Smith: Comments to Uniform Voidable Transactions Act Should Not Be Changed

Kenneth C. Kettering and **Edwin E. Smith** provide members with their perspective on the Official Comments to the 2014 amendments to the Uniform Fraudulent Transfer Act (renamed the Uniform Voidable Transactions Act).

Kenneth C. Kettering is **Lecturer in Law** at **Columbia University School of Law**. He was the reporter for the 2014 amendments to the UFTA/UVTA.

Edwin E. Smith is a partner of **Morgan, Lewis & Bockius LLP** and a commissioner from Massachusetts to the Uniform Law Commission. He was the chair of the drafting committee for the 2014 amendments to the UFTA/UVTA.

Here is their commentary:

EXECUTIVE SUMMARY:

In Asset Protection Newsletter #327, **Richard W. Nenno** and **Daniel S. Rubin** criticized two comments to the Uniform Fraudulent Transfer Act as amended in 2014 (and renamed the Uniform Voidable Transactions Act). They urged that those comments be changed to remove references to decisions holding that a transfer to a self-settled spendthrift trust may be avoidable under the basic rule of fraudulent transfer law. Removing the references would be a disservice to the legal community.

COMMENT:

Introduction

Richard W. Nenno and Daniel S. Rubin published a newsletter entitled “Are Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Voidable Transfers Per Se?” in Asset Protection Newsletter #327. The

newsletter deals with the 2014 amendments to the Uniform Fraudulent Transfer Act, which the amendments renamed the "Uniform Voidable Transactions Act." We will refer to the act pre-amendment as the "UFTA," the act post-amendment as the "UVTA," and the act pre- and post- amendment as "the act" or "UFTA/UVTA."

The 2014 amendments make only minor changes to the act, but they are desirable changes. We think that states that have enacted the UFTA but not yet enacted the 2014 amendments should do so promptly, and that the few remaining states that have not yet enacted the act at all should do so. For that reason we think it appropriate to respond to the newsletter.

Background and Purpose

The newsletter by Messrs. Nenno and Rubin does not criticize the black letter of the act. Its complaint is only with two comments to the act. Specifically, the newsletter proposes to delete the two passages of the comments that make reference to cases holding that a transfer by a debtor to a spendthrift trust for the debtor's own benefit was a fraudulent transfer.[1]

The UFTA/UVTA differs from most uniform acts in its antiquity. Its basic rule declares voidable any transfer of property by a debtor made with "intent to hinder, delay, or defraud" any creditor of the debtor.[2] Those are the very same words, inconsequentially reordered, that were used to express the rule in 1571 in the English Statute of 13 Elizabeth, which was received into the law of the American colonies.[3] The 2014 amendments did not tamper with that time-honored rule. Because its basic rule has been in force for a very long time, the comments to the act are largely concerned with describing precedents that have interpreted the rule. The act was accompanied by extensive comments when it was first issued in 1984.

The 1984 comments were refreshed as part of the 2014 amendment project. The comments were revised along with the statutory text, and the 2014 drafting committee considered the comments fully. One of the authors of the newsletter was an observer to the drafting committee, attended drafting committee meetings and made constructive suggestions throughout the process. Although a number of his views, expressed in the drafting committee meetings and in email correspondence, were not accepted by the drafting committee, they were respectfully and fully considered.

The passages in the comments that the newsletter proposes to delete refer to cases that interpreted the time-honored rule that is the act's basic rule today. Those cases were unanimous, and they have not been overruled. They deserve mention in the comments.

The Cases

The case references that the newsletter proposes should be deleted relate to asset protection trusts established in states that do not have legislation validating such trusts. "Asset protection trust" of course is just another name for a self-settled spendthrift trust. Spendthrift trusts were not recognized in English law. They originated in Pennsylvania in the mid-1800s, due to a quirk in Pennsylvania equity jurisprudence at the time.[4] Soon after the spendthrift trust was invented, a creative Pennsylvania debtor transferred assets into a spendthrift trust for his own benefit, and so created the first asset protection trust. The Pennsylvania Supreme Court held the transfer to the trust to be a violation of the basic rule of fraudulent transfer law, as then embodied in the Statute of 13 Elizabeth.[5] Later cases reiterated that holding.[6] As the spendthrift trust spread from Pennsylvania to other states, courts in other states took the same position.[7] The negative reaction of the courts to this device was also incorporated into trust law doctrine, which independently permitted the debtor's creditors to reach the debtor's interest in the conveyed assets.[8]

These cases have not been overruled. Furthermore, so far as we are aware, the cases are unanimous. The newsletter cites no case that has ever held that a transfer to a self-settled spendthrift trust is exempt from the basic rule of fraudulent transfer law.

The Relationship of the Comments to the Cases

The argument offered in the newsletter as to why these unanimous, not-overruled cases should not be viewed as having precedential force is that the fraudulent transfer law of the relevant states today "does not provide that a transfer to a self-settled spendthrift trust is a voidable transfer per se."[9] It is no doubt true that neither now nor then did any relevant statute say in so many words that a transfer to a self-settled spendthrift trust is avoidable. But the legal rule applied by those cases was the same then and now. It is the time-honored language of the Statute of 13 Elizabeth that has been in force for centuries and continues as the basic rule of the UFTA/UVTA today: "intent to hinder, delay, or defraud" any creditor. It is the same rule, the same words,

then and now.

Of course a legislature might intervene with enactments that supersede fraudulent transfer law. The states that have in recent years validated local asset protection trusts that meet certain parameters evidently have done that at least to some extent. The exact extent to which those enactments supersede those states' fraudulent transfer laws will depend upon the specifics of the local enactments. The comments to the 2014 amendments note that states that have enacted statutes validating asset protection trusts will have superseded the state's fraudulent transfer statute to the extent provided in those statutes.[10]

The newsletter asserts that the comments are flawed because "the law does not provide that a transfer to a self-settled spendthrift trust is a voidable transfer per se."[11] However, the newsletter does not state accurately what the comments actually say.

First, the comments nowhere say that "the law provides" that such a transfer is voidable. The comments merely point out that such has been the historical interpretation of the basic rule by the courts. The comments are carefully worded to recognize that it is not necessarily the case that all courts in all states will always follow that historical interpretation.[12]

Second, the comments nowhere use the phrase "per se" to refer to the voidability of such a transfer. One reason for that is a point made in the newsletter itself: the basic rule of fraudulent transfer law applies only if the debtor makes the challenged transfer with "intent" to hinder, delay, or defraud any creditor. "Intent" is a mutable term in the law, and is given different meanings in different settings. For example, a defendant in a criminal proceeding for which intent is an element can be confident that "intent" will be taken to refer to his subjective mental state, but a company that screens prospective employees by using a test that passes 100% of white males and 0% of the members of one or more protected classes is likely to find that that a court will not be interested in the subjective mental states of the persons in the HR department, notwithstanding that the applicable antidiscrimination statute prohibits the making of employment decisions with "intent" to discriminate against members of a protected class.

Courts applying the basic rule of fraudulent transfer law have often taken the view that a debtor "intends" the natural consequences of the actions he takes, and so have eschewed inquiry into the debtor's subjective mental

state. However, courts have not been consistent on this point.[13] The courts in the cases noted above involving a transfer to a self-settled spendthrift trust took the objective view and were not concerned with the debtor's subjective mental state. The comments nevertheless cautiously avoid making a judgment on this point by avoiding use of "per se."

That courts that have adjudicated the issue have held that transfers to self-settled spendthrift trusts are avoidable under the basic rule of fraudulent transfer is an historical fact. Apart from those cases, the newsletter advances various arguments as to why courts today should hold otherwise. Because our purpose in writing is only to demonstrate the accuracy and integrity of the comments, discussion of those arguments is beyond the scope of this note.

Mention of the Cases in the Comments is a Service to the Bar

Lawyers counseling clients have a need for ready availability of the facts about how courts have dealt with situations in the past, so that they can properly assess the risks. The comments are intended to provide those facts and so to be of service to those who consult the statute. It would be a disservice to the bar and the clients they serve for the comments cited in the newsletter to be deleted.[14]

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Kenneth C. Kettering

Edwin E. Smith

COMMENT BY TECHNICAL EDITOR DUNCAN OSBORNE: I have been studying the law of fraudulent transfers for

over 45 years and have spent untold time not only with the statutes and the cases, but also with the works of Professor Robert Danforth and Professor Peter Alces. My conclusions from this intense involvement leave me firmly convinced of the positions of Mr. Rubin and Mr. Nenno.

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CITATIONS:

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[1] "At a minimum, we believe that a state considering enactment of the UVTA should drop all of Comment 2 under Section 4 (except the first sentence) as well as the last paragraph of Comment 8 under Section 4." Newsletter ¶61. (In the count of paragraphs, block-quoted text is not counted as a separate paragraph.)

[2] UFTA/UVTA § 4(a)(1).

[3] An Acte agaynst fraudulent Deedes Gyftes Alienations, &c., 1571, 13 Eliz., c. 5, para. 1 (Eng.) ("Intent to delaye hynder or defraude Creditors"), *reprinted in* 4 Statutes of the Realm 537 (1819).

[4] *See* Erwin N. Griswold, Spendthrift Trusts §§ 25-33, at 21-33 (2d ed. 1947).

[5] *MacKason's Appeal*, 42 Pa. 330, 338–39 (1862).

[6] *See, e.g.*, *Ghormley v. Smith*, 139 Pa. 584, 591 (1891) (such an arrangement is "against the public policy, as well as the statute of Elizabeth"); *Patrick v. Smith*, 2 Pa. Super. 113, 119 (Super. Ct. 1896) ("The prohibition of conveyances with intent to delay, hinder or defraud creditors, would be of little use if the debtor may put his estate beyond the reach of creditors and still get a living from it.").

[7] *See, e.g.*, *State v. Nashville Trust Co.*, 190 S.W.2d 785, 790 (Tenn. Ct. App. 1944) ("[T]he case is very different when one takes his own property and undertakes to put it into a trust for his own benefit beyond the reach of his creditors. Such a trust … violates not only the general principle that one's property is liable for his debts but also the law of fraudulent conveyances. All the authorities say that one cannot create a spendthrift trust with his own property for his own benefit.", citing many authorities, including *J.S. Menken Co. v. Brinkley*, 31 S.W. 92, 94–95 (Tenn. 1895)); *Jamison v. Miss. Valley Trust Co.*, 207 S.W. 788, 789 (Mo. 1918); *Petty v. Moores Brook Sanitarium*, 67 S.E. 355, 356–57 (Va. 1910). A great many other cases state the same rule and refer to it indifferently as a matter of fraudulent conveyance law and of trust law, or simply rely on precedents. An example of the former type, which cites many other cases, is *Herd v. Chambers*, 149 P.2d 583, 589 (Kan. 1944), which quoted 37 C.J.S. Fraudulent Conveyances § 219: "The general rule is well settled both at common law and under statute that a person cannot settle his estate in trust for his own benefit, so as to be free from liability for his debts." For an example of the latter type, see *Deposit Guaranty Nat. Bank v. Walter E. Heller & Co.,* 204 So.2d 856, 862 (Miss. 1967), which cites, *inter alia*, *MacKason's Appeal*, 42 Pa. 330 (1862). The current edition of 37 C.J.S. Fraudulent Conveyances § 139, and surrounding sections, cites many cases for the following black-letter proposition: "As a general rule, a conveyance of real or personal property in trust for the benefit of the grantor is fraudulent as to both existing and subsequent creditors regardless of the intention of the parties or the solvency of the grantor...."

[8] *See* Restatement (Third) of Trusts § 58(2) (2003); Restatement (Second) of Trusts § 156(1) (1959); Restatement of Trusts § 156(1) (1935).

[9] Newsletter ¶21. Essentially the same language also appears in paragraph 22.

[10] UVTA § 4 cmt. 8 ¶7 ("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).)”).

[11] Newsletter ¶12.

[12] “*If* [state Y] follows the *historical interpretation* referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y.” UVTA § 4 cmt. 8 ¶7 (emphasis added).

[13] For further discussion of “intent” under fraudulent transfer law, see Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 Bus. Law. 777, 806-10 (2015), Kenneth C. Kettering, S*ecuritization and Its Discontents: The Dynamics of Financial Product Development,* 29 Cardozo L. Rev. 1553, 1613-20 (2008), and Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 Cardozo L. Rev. 531, 537-39, 575-77 (1987). Professor Kennedy was the reporter for the drafting committee that wrote the UFTA.

[14] The views expressed herein are those of the authors, and are not necessarily those of the Uniform Law Commission, either author’s law firm or employer, or any other person or entity.

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