

RESOLUTION 06-04-2007

DIGEST

Property: Preventing Fraudulent Transfers without Equity

Amends Civil Code section 3439.01 to prevent a judgment debtor from fraudulently transferring property that is presently exempt or without equity.

RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

History:

No similar resolutions found.

Reasons

This resolution amends Civil Code section 3439.01 to prevent a judgment debtor from fraudulently transferring property that is presently exempt or without equity. This resolution should be approved in principle because it would prevent a judgment debtor from transferring real or personal property that is subject to lien or without equity at the time of transfer, but which may have considerable equity develop in a rising economic market.

Current law permits a debtor to convey property, even without consideration, to an insider or relation in order to avoid satisfaction of indebtedness if there is no equity at the time of transfer. However, the transferred property may still have considerable potential for appreciation over time (such as California real estate) and could therefore become a source for satisfaction of indebtedness in the future.

The proposed change in the statutory scheme would have no effect on a good faith transfer of property that is not intended to hinder, delay or defraud creditors. It would apply only to those transfers of property that, for want of a better word, are a sham, where control by the debtor is maintained. Such property could then be used to satisfy the claims of creditors at a later time.

TEXT OF RESOLUTION

RESOLVED that the Conference of Delegates recommend that legislation be sponsored to amend California Civil Code § 3439.01 to read as follows:

- 1 §3439.01
- 2 As used in this chapter the following definitions are applicable:
- 3 (a) "Asset" means property of a debtor, but the term does not include ~~the~~
- 4 ~~following:~~
- 5 (1) ~~Property to the extent it is encumbered by a valid lien.~~
- 6 (2) ~~Property to the extent it is generally exempt under nonbankruptcy law.~~
- 7 (3) ~~An~~ an interest in property held in tenancy by the entireties to the extent it is
- 8 not subject to process by a creditor holding a claim against only one tenant.

9 (b) "Claim" means a right to payment, whether or not the right is reduced to
10 judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed,
11 undisputed, legal, equitable, secured, or unsecured.

12 (c) "Creditor" means a person who has a claim, and includes an assignee of a
13 general assignment for the benefit of creditors, as defined in Section 493.010 of the
14 Code of Civil Procedure, of a debtor.

15 (d) "Debt" means liability on a claim.

16 (e) "Debtor" means a person who is liable on a claim.

17 (f) "Lien" means a charge against or an interest in property to secure payment
18 of a debt or performance of an obligation, and includes a security interest created by
19 agreement, a judicial lien obtained by legal or equitable process or proceedings, a
20 common-law lien, or a statutory lien.

21 (g) "Person" means an individual, partnership, corporation, limited liability
22 company, association, organization, government or governmental subdivision or
23 agency, business trust, estate, trust, or any other legal or commercial entity.

24 (h) "Property" means anything that may be the subject of ownership.

25 (i) "Transfer" means every mode, direct or indirect, absolute or conditional,
26 voluntary or involuntary, of disposing of or parting with an asset or an interest in an
27 asset, and includes payment of money, release, lease, and creation of a lien or other
28 encumbrance.

29 (j) "Valid lien" means a lien that is effective against the holder of a judicial
30 lien subsequently obtained by legal or equitable process or proceedings.

(Proposed new language underlined; language to be deleted stricken.)

PROPONENT: Orange County Bar Association

STATEMENT OF REASONS:

Existing Law: Current law allows a judgment debtor to fraudulently transfer property that has no equity or that is exempt, thereby allowing the judgment debtor to keep property that has the potential to appreciate in value from the reach of creditors.

This Resolution: This resolution eliminates the ability of a judgment debtor to fraudulently transfer property that presently may not have available equity but that may have substantial future value as a result of appreciation.

The Problem: The current definition of "Asset" allows a judgment debtor to defraud his/her creditors by allowing the judgment debtor to transfer property to relatives and friends for no consideration and then to shield the transfer from being set aside by arguing that the property had no equity at the time of the transfer. In California, real property usually appreciates in value over time. Thus, it is inevitable that the transferred property will eventually have equity. A judgment debtor with intent to defraud his/her creditors should not be permitted to keep the appreciation value of his/her property. The proposed revision will not affect a legitimate transfer made by an honest debtor. If the property truly has no value and it is given away for no consideration with no bad intent, the transfer could not be set aside under current law.

IMPACT STATEMENT:

This resolution does not affect any other law, statute or rule.

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COUNTERARGUMENTS

BAR ASSOCIATION OF SAN FRANCISCO

There are two significant problems with this resolution. The first has to do with the policy change it proposes. The second is that the specific language of the resolution would not accomplish the proponent's goal.

The proponent wants a transferee of property from a debtor to be liable to the debtor's creditors for any increase in the value of the property, even though the property had no value to creditors at the time of the transfer, either because it was exempt from judgment enforcement or because it was fully encumbered. This proposal would reverse decades of California law. See, *Bailey v. Leeper* (1956) 142 Cal. App. 2nd 460, 465 [(T)he date of the transfer is the critical date against which the validity of the transfer is to be tested ...Fluctuating values after the date of transfer could neither be allowed to help or hinder the determination of fair value."].

Aside from questionable arguments about property "inevitably" increasing in value (please refer to the current market in most places for residential real estate), the proponent's argument necessarily rests on the assumption that acquiring exempt or encumbered property is a riskless proposition. The ownership of property ordinarily involves risk. First, there is the risk the property may decline in value, and second there is the risk that the cost of owning the property (mortgage interest, taxes, maintenance, for example) may exceed the value of the property. Proponent, however, wants a debtor's creditors to be able to stand by (presumably for four years—the statute of limitations on fraudulent transfers), and undertake none of the risk of ownership of the transferred property, but enjoy all the benefits of any appreciation in value. "That's nice work if you can get it," but the Conference should consider whether that is how the law should operate.

The other problem with the resolution is that the proposed amendment to Civil Code § 3439.01 would not accomplish the proponent's goal. Section 3439.01 is a definitional section, and the proponent wants to change the definition of the term "asset." However, the term "asset" is otherwise used in the Uniform Fraudulent Transfer Act only for purposes of determining whether the transferor/debtor is insolvent. Civ. Code § 3439.02. Other provisions of the Act do not use the term "asset," and hence would be unchanged. For example, § 3439.08 provides that a transfer is not voidable "against a person who took in good faith and for a reasonably equivalent value...." Thus, a person who in good faith acquired fully encumbered property (and assumed

the risk of paying the encumbrance) for a token amount would not be subject to having the transfer voided, notwithstanding the proposed amendment to the definitional section.

For the above reasons, the Bar Association of San Francisco urges that Resolution 06-04 be disapproved.

SAN DIEGO COUNTY BAR ASSOCIATION

The resolution is extremely broad and, at the same time, limiting. It appears to be targeting (as are many of this year's resolutions) fraudulent conveyances. It does not, however, provide a convincing reason why an individual should not be able to transfer property, particularly amongst family, for whatever terms are negotiated. The current law on fraudulent conveyance seems an adequate protection against unlawful acts of transfer. True, there may be errant cases where justice is not done, but that is insufficient justification to forbid and invalidate property transfers without proof of intent.

SANTA CLARA COUNTY BAR ASSOCIATION

This resolution is unnecessary and unclear. The proponent claims that it will prevent the fraudulent transfer of property by a judgment debtor while still allowing "legitimate transfers" by "honest debtors." Nothing in the resolution, though, explains how this determination is to be made at the time of transfer. Moreover, the simple fact is that the statute, as written, permits transfers of property by a judgment debtor in certain circumstances – specifically property that is already generally exempt under the bankruptcy law or that is encumbered by a valid lien. As noted in the Statement of Reasons, property in California tends to increase in value over time so it stands to reason that the legislature, aware of this fact, still decided that such transfers should be allowed. While it may be true that some people have taken advantage of this particular language and, thus, make transfers that are not totally above board, there is nothing to indicate that this is a widespread problem that needs any corrective action or that this is the proper way to fix it.