

CREDITORS' RIGHTS AND
BUSINESS RESTRUCTURING

FEBRUARY
2018

A L E R T

WHAT PENNSYLVANIA CREDITORS NEED TO KNOW ABOUT THE NEW UNIFORM VOIDABLE TRANSACTIONS ACT

By Jonathan W. Hugg

For at least 100 years, state law has provided statutory protections for creditors, establishing remedies in situations where a debtor transfers property or diminishes assets in ways that impede recovery. The Pennsylvania General Assembly and Governor Wolf recently enacted significant changes in this area of law.

On February 20, 2018, the Uniform Voidable Transactions Act (“PUVTA”) becomes the law in Pennsylvania. The new statute applies to transfers and obligations incurred after that date. The PUVTA renames and changes the 1993 Pennsylvania Uniform Fraudulent Transfer Act to create a more creditor-friendly law that should facilitate the recovery of debt and discourage or more easily remedy the dissipation of assets by debtors. In particular, the PUVTA:

- Replaces “Fraudulent” with “Voidable”: This is not merely a benign, stylistic change of wording. Unfortunately, the use of fraud language has caused some judges to impose unnecessarily high requirements on creditors. This is because fraud is quasi-criminal and therefore harder to prove. These judges have not recognized that a “fraudulent transfer” is really a misnomer. A debtor does not need to commit an intentional deception to engage in a fraudulent transfer. Rather, “constructive”

fraud – i.e., an exchange where a debtor gives away property without receiving equal value in return, or which occurs when the debtor is insolvent, or which renders the debtor insolvent – may also suffice for a fraudulent transfer. The use of the word “voidable,” not “fraudulent,” in the PUVTA will put the emphasis on rolling back transactions that prejudice creditors, so as to make more assets available for execution.

- Explicitly Sets a Preponderance of the Evidence Standard: With the passage of the PUVTA, the law is now clear and unambiguous that creditors need only establish their claims by a “preponderance of the evidence.” This is the usual level of proof in a civil case. It means that a fact is “more likely than not.” The preponderance level is significantly less demanding than the “clear and convincing evidence” standard used by some judges, which is the highest standard in civil law, and which is commonly needed to prove fraud; the only greater level of evidence is the “beyond a reasonable doubt” standard in criminal cases. Judges can no longer confuse a “fraudulent transfer” for fraud and demand that creditors produce extra evidence of specific and intentional wrongdoing by debtors.

- Narrows Defenses: Under the PUVTA, to show that a transfer is not voidable, the recipient of a debtor's property must now show not only good faith but also that the recipient gave the debtor "reasonably equivalent value" in exchange. It is insufficient for a party related to the debtor, such as a family member, owner, or affiliate, to receive the consideration. Requiring direct privity with the debtor prevents the debtor from benefiting through a secret agreement with a third party. Payment directly to the debtor, rather than enriching a third party, also comports with the objective of maintaining the value of the debtor so that there is equity available to satisfy the debtor's obligations. Furthermore, not only the first transferee of an asset from the debtor, but also all subsequent transferees, must take in good faith. A debtor cannot shelter an asset by initially transferring it to an innocent party, who then blamelessly re-transfers the property to a party acting in bad faith, aligned with the debtor.

The PUVTA also includes new provisions that should simplify litigation, including rules for determining the location of a debtor and the governing law. However, one revision that may result in more litigation is a change in the definition of insolvency. "Insolvency" is central to the PUVTA. Because transactions that occur when a debtor is insolvent, or which make a debtor insolvent, may prejudice creditors, the PUVTA allows creditors to set those transfers aside. However, the solvency or insolvency of the debtor at the time is the underlying fundamental question. A debtor is presumed to be insolvent when it is not paying its debts as they become due – except that under the PUVTA, this calculus does not consider debts that are the subject of "a bona fide dispute." Because most debtors believe that they have reasonable defenses to payment and rationales for non-payment, the "bona fide dispute" exception will doubtlessly generate substantial litigation.

An unknown judge or legal scholar wrote long ago that the law requires debtors "to be just before

being generous." Out of fairness, debtors must make their creditors whole prior to enriching themselves or family and friends. However, the temptation of debtors to ignore creditors out of self-interest or alleged philanthropic motives can be overwhelming. By changing the focus of the law from "fraudulent transfers" to "voidable transactions," the PUVTA will encourage courts to view the exercise of creditors' rights not as punitive punishment against debtors but instead as restorative justice. This subtle new emphasis may in the long term be the greatest impact of the new statute. ♦

This summary of legal issues is published for informational purposes only. It does not dispense legal advice or create an attorney-client relationship with those who read it. Readers should obtain professional legal advice before taking any legal action.

For more information about Schnader's Creditors' Rights and Business Restructuring Practice Group or to speak with a member of the firm, please contact:

*Richard A. Barkasy
Chair, Creditors' Rights and Business
Restructuring Practice Group
rbarkasy@schnader.com
215-751-2526*

*Jonathan W. Hugg
Partner
jhugg@schnader.com
215-751-2527*

www.schnader.com
© 2018 Schnader Harrison Segal & Lewis LLP
* See: www.schnader.com/jakarta