

Memorandum 81-23

Subject: Study D-801 - Transfer Between Members of Household as
Fraudulent Conveyance (Comments on Tentative Recommendation)

Civil Code Section 3440 provides that a transfer of personal property is conclusively presumed fraudulent as to creditors if there is no change of possession between the transferor and transferee. This rule makes a transfer between members of the same household practically impossible, at least as it affects creditors, since each member of the household may be said to remain constructively in possession of the personal property within the household. For this reason, the Commission has tentatively recommended that the conclusive presumption of fraud created by Section 3440 not be applicable to transfers between members of the same household. A copy of the tentative recommendation is attached. This recommendation would affect neither (1) the inference of fraud that may arise from the circumstances of the transfer and the relationship of the parties nor (2) the application of the general provisions of the Uniform Fraudulent Conveyance Act.

The comments received on the tentative recommendation are attached as Exhibits 1-5. Professor Lloyd Tevis (Exhibit 2) sees "nothing to object to" in the proposed legislation. Allen J. Kent (Exhibit 3) approves the tentative recommendation. Brian W. Newcomb of the San Mateo County Legal Aid Society (Exhibit 4) also approves the tentative recommendation; he points out that his clients, on occasion, make bona fide transfers of personal property that are threatened by the fraudulent conveyance presumption. Justice Robert Kingsley (Exhibit 5) thinks the proposal is sensible, but would extend it further: there should be no inference of fraud in transfers of property between household members where the property is of small value, e.g., less than \$5,000.

On the other hand, the State Bar Debtor/Creditor and Bankruptcy Subcommittee was unanimously opposed to the tentative recommendation; this was also the view of the Executive Committee of the Business Law Section of the State Bar. See Exhibit 1. The State Bar points out that most intra-family transfers are already excepted from the operation of

Section 3440 by subdivision (f), which excepts property exempt from execution, such as household goods. In case of a transfer of property not exempt from execution, such as an expensive car or a valuable work of art, the State Bar believes the conclusive presumption of fraud should apply. It is the experience of the State Bar subcommittee members that "one of the most common violations of Civil Code § 3440 arises when one spouse transfers property to the other spouse in an attempt to evade creditor action." The State Bar recognizes that this rule impedes the ability of spouses to transmute community to separate property, but argues that if this is to be permitted, it should not be to the detriment of creditors; the statute could be drafted so that, for example, the transmutation would not be conclusively fraudulent if the parties were left solvent and if creditors received notice of the transmutation by recording.

Under the Uniform Fraudulent Conveyance Act, a transfer of property is fraudulent as to creditors if it is made with fraudulent intent or if it renders the transferor insolvent. The staff believes that, properly analyzed, the effect of Section 3440 is to supply an objective test for the subjective issue of fraudulent intent. A transfer of property without change of possession is inherently suspect. Such a transfer creates an inference of fraud where the parties are in the same household; should this inference be a conclusive presumption? The rule of Section 3440 is one of efficiency in the administration of justice--all suspect transfers are conclusively presumed fraudulent. This eliminates litigation and troublesome proof problems over the issue; it is also consistent with general experience that such transfers are ordinarily intended to defraud creditors. The Commission's tentative recommendation recognizes that not all suspect transfers are necessarily fraudulent; equity requires that the parties be given the opportunity to rebut the inference of fraud. This rule in effect permits litigation for the benefit of the few cases where the suspect transfer is actually bona fide.

The staff agrees with the State Bar's analysis of the problem--most intra-family transfers are already protected by the exception for exempt property; where the transfer is of non-exempt property, there is a substantial likelihood that the transfer is fraudulent and the presumption is proper. In addition, if the transfer has not rendered the transferor insolvent (which would be an additional basis for finding the

transfer fraudulent), the transferor may satisfy creditors out of other property if the transferor wishes to preserve the transfer. On the whole, the staff believes the existing conclusive presumption of fraud is sound in its application to nearly all situations and helps reduce litigation.

Whether or not the Commission decides to submit its tentative recommendation to the Legislature, there are a number of technical problems in Section 3440 that should be cleaned up. Subdivision (c) refers to "contract rights" governed by the Uniform Commercial Code; the code no longer uses "contract rights" terminology, and the subdivision should be revised to refer to "general intangibles instead." Subdivision (e) refers to an assignment "statutory or otherwise" for the benefit of creditors generally; statutory assignments were repealed on recommendation of the Commission and this reference should be deleted. Subdivision (h) and the paragraph following provide for a notice to creditors of a sale and leaseback or security interest comparable to the notice of a bulk sale; the bulk sale notice requirements have been amended to provide 12 days' notice to creditors, and the times in subdivision (h) and the paragraph following should be conformed.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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May 26, 1981

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John E. Demouilly
Executive Secretary
California Law Revision
Commission
400 Middlefield Road
Room D2
Palo Alto, California 94306

Re: Study 801 - Creditor's Remedies (Inter-
family transfer as fraudulent conveyance)

Dear John:

I am writing to you in my official capacity as Chairman of the Debtor/Creditor and Bankruptcy Subcommittee of the Business Law Section of the State Bar of California and am also authorized by the Executive Committee of the Business Law Section of the State Bar to state that they concur with the views expressed in this letter.

The Debtor/Creditor Relations and Bankruptcy Subcommittee of the Business Law Section has undertaken a study of the proposed amendment to Civil Code §3440. At a recent meeting of our subcommittee, there was a unanimous vote to oppose the proposed amendment to California Civil Code §3440. A decision was also made by the Executive Committee of the Business Law Section to oppose the amendment, if introduced in the legislature.

It is the experience of the members of my subcommittee that one of the most common violations of Civil Code §3440 arises when one spouse transfers property to the other spouse in an attempt to evade creditor action. It was also the feeling of the subcommittee that most of the property which

John E. Demouilly
May 26, 1981
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would be included under the proposed exception to Civil Code §3440 would be exempt in any event, in which case the statute would not come into play. With respect to major items of personal property which would not be exempt, such as automobiles, works of art, etc., it was the subcommittee's belief that Section 3440 should not have the proposed exception created.

The subcommittee did recognize, however, that there are legitimate non-creditor grounds relating to marital relations where spouses may wish to agree not to hold property as community property, or may wish to divide their existing community property and hold only separate property. Section 3440 does presently stand in the way of such agreements. Perhaps the Law Revision Commission can draft a narrower exception to Civil Code §3440 to cover such circumstances. For example, the Commission might consider an exception which is only applicable if the spouses can establish that they were solvent both before and after the transfer and that they have published and recorded an inventory of separate personal property as provided for in Civil Code §5114, 5115. Such an exception would be similar to the recordation exception found in Section 3440(h), with respect to sale and leasebacks.

Very truly yours,



Alan Pedlar

AP/gjt



LOYOLA LAW SCHOOL

March 25, 1981

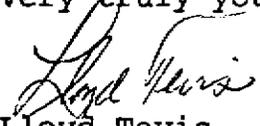
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Gentlemen:

This is in response to your Tentative Recommendation relating to Transfer Between Members of Household As Fraudulent Conveyance. Because you state that it is important to advise you of approval when one has no objections, this is to state that I see nothing to object to in the legislation you propose.

I do hope that this is not to be your last look at Civil Code section 3440 and fraudulent conveyance law in general. I do not find this subject specifically mentioned in your most recent (Dec., 1980) Annual Report under the heading of Enforcement of Judgments or elsewhere. Yet it is a subject in need of study.

Very truly yours,


Lloyd Tevis
Professor of Law

LT:nm

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February 24, 1981

California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Gentlemen:

I approve the tentative recommendation relating to transfers between members of household as fraudulent conveyance.

I am also returning the mailing list notice.

Very truly yours,



ALLEN J. KENT

AJK/vg
Enclosure

LEGAL AID SOCIETY OF SAN MATEO COUNTY

PETER H. REID
EXECUTIVE DIRECTOR

2221 BROADWAY
REDWOOD CITY, CALIFORNIA 94063
TELEPHONE (415) 365-8411

February 24, 1981

California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94306

Re: Tentative Recommendation Relating
to Transfer Between Members of
Household as Fraudulent

Dear Sir:

I am in receipt of the Commission's tentative recommendation regarding the amendment of C.C. §3440.

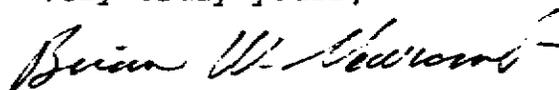
I approve the addition of subdivision (i) to said code section thereby exempting a transfer of personal property between members of a household from the conclusive presumption of fraud created by Section 3440 when there is no actual charge of possession.

I also concur in the Commission's analysis, that Civil Code § 3440 does not presently recognize the realities of a transfer of personal property between household members.

On occasion, problems arise in our client population due to transfers of personal property between household members. Not only are there threats that the bona fide transfer will be set aside by a creditor but some clients are denied governmental benefits to which they are entitled due to transfers of personal property within the household.

Thank you for the opportunity to comment upon this recommendation.

Very truly yours,



BRIAN W. NEWCOMB
Attorney at Law

BWN: jr

STATE OF CALIFORNIA
COURT OF APPEAL
SECOND DISTRICT—DIVISION FOUR
3580 WILSHIRE BOULEVARD
LOS ANGELES, CALIFORNIA 90010

February 27, 1981

ROBERT KINGSLEY
ASSOCIATE JUSTICE

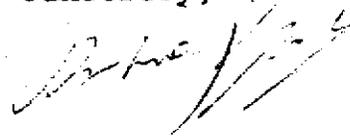
California Law Revision Commission,
4000 Middlefield Road,
Palo Alto, California 94306

Gentlemen:

- (1) I enclose the form requesting continuance of mailing to me your reports and preliminary drafts.
- (2) I have reviewed your Tentative Recommendation relating to Transfers Between Members of a Household.

So far as it goes, I think the proposal sensible. However, I suggest that you consider some change in the rule (you cite Wood v. Kaplan, 178 Cal.App.2d 227), raising an inference of fraud in case of intra-family transfers. Would it not be a pragmatic concept to make any such transfer not subject to the inference if of small value -- say under \$5,000. Probably most creditors would not bother in such cases but there are always some who want their full pound of flesh and it seems a waste of judicial time to worry over minimal transfers. In other words, I would remove the inference in some cases not covered by section 690 et seq., of the Code of Civil Procedure.

Sincerely,



Enclosure

TENTATIVE RECOMMENDATION

relating to

TRANSFER BETWEEN MEMBERS OF HOUSEHOLD AS FRAUDULENT CONVEYANCE

If a transfer of property from one member of a household to another has the effect of defeating creditors, the transfer is inherently suspect. The likelihood of fraud in this situation is sufficiently great that, in addition to the general rules governing fraudulent conveyances,¹ two other rules apply to such a transfer:

(1) The transfer is conclusively presumed fraudulent as to creditors if there is no immediate delivery of the property followed by an actual and continued change of possession.²

(2) The intimate relationship between the parties to the transfer may raise an inference of fraud as to creditors.³

The conclusive presumption of fraud is ill-suited to transfers between members of a household.⁴ The main purpose of Civil Code Section 3440 in requiring an immediate delivery and continuous change of possession is to give notice to creditors.⁵ This purpose is difficult to achieve in a household setting where the personal property that is transferred may remain in the same place as before and may be used by the same persons of the household who originally used it. The transfer

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1. Uniform Fraudulent Conveyance Act, Civil Code §§ 3439-3439.12. The act affects the validity of a transfer as to third-party creditors and not as between the parties to the transfer.
 2. Civil Code § 3440. Section 3440 governs all transfers in which there is no delivery and change of possession of the property transferred, including transfers within the household. See, e.g., Pfunder v. Goodwin, 83 Cal. App. 551, 257 Pac. 119 (1927); Gardner v. Sullivan & Crowe Equipment Co., 17 Cal. App.3d 592, 94 Cal. Repr. 893 (1971).
 3. See, e.g., Wood v. Kaplan, 178 Cal. App.2d 227, 2 Cal. Rptr. 917 (1960).
 4. See Bruch, Management Powers and Duties Under California's Community Property Laws at p. 68 (1980). This is a study prepared for the California Law Revision Commission, which will be published shortly.
 5. See Joseph Henspring Co. v. Jones 55 Cal. App. 620, 203 Pac. 1038 (1921).

of possession from one member to another of personal property within or incident to the household may not be apparent to the rest of the world.

Transfers of personal property between household members tend to be casual and informal. The formalities applicable to a transfer in a purely business relationship are unwarranted in a family setting. Failure of delivery between household members should not be conclusively presumed fraudulent. The members should at least have the opportunity to rebut the presumption of fraud and show that the transfer was bona fide. Absent such an opportunity, every transfer among household members, even though bona fide, will be fraudulent as to creditors since the transferor will always remain in constructive possession as a member of the household.

Removal of the conclusive presumption of fraud in transfers of personal property between members of the same household where there is no immediate and continued change of possession would not validate transactions made with the purpose of defeating creditors. Other mechanisms in the Civil Code test such transactions for fraud. The Uniform Fraudulent Conveyance Act enables creditors to avoid such transfers not only if they were made with fraudulent intent but also if they were made for less than a fair consideration and either resulted in the transferor's insolvency or were made once the transferor was already insolvent. In the reported cases dealing with family members, inequitable results to third-party creditors could readily have been avoided on the facts presented under other provisions of the Uniform Fraudulent Conveyance Act.⁶

In addition, elimination of the conclusive presumption of fraud will not invalidate the inference of fraud that may be drawn from an interfamily transfer. It has been held judicially that since direct proof of fraudulent intent is often an impossibility because the real intent of the parties and the facts of a fraudulent transaction are peculiarly within the knowledge of those sought to be charged with fraud, proof indicative of fraud may be inferred from circumstances

6. See Bruch, loc. cit.

surrounding the transaction, the relationship, and interest of the parties.⁷ The relationship of parent and child, for example, when coupled with suspicious circumstances may be sufficient to raise an inference of fraud in a conveyance from one to the other.⁸

The Commission recommends that an exception be made for transfers between members of a household from the conclusive presumption of fraud of Civil Code Section 3440 where there is no delivery and change of possession of personal property. The Commission's recommendation would be effectuated by enactment of the following provision:

An act to amend Section 3440 of the Civil Code, relating to fraudulent conveyances.

SECTION 1. Section 3440 of the Civil Code is amended to read:

3440. Every transfer of personal property and every lien on personal property made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred, is conclusively presumed fraudulent and void as against the transferor's creditors while he remains in possession and the successors in interest of those creditors, and as against any person on whom the transferor's estate devolves in trust for the benefit of others than the transferor and as against purchasers or encumbrancers in good faith subsequent to the transfer.

This section shall not apply to any of the following:

- (a) Things in action.
- (b) Ships or cargoes at sea or in a foreign port.
- (c) Security interests and the sale of accounts, contract rights or chattel paper governed by the Uniform Commercial Code, and contracts of bottomry or respondentia.
- (d) Wines or brandies in the wineries, distilleries, or wine cellars of the makers or owners of the wines or brandies, or other persons having possession, care, and control of the wines or brandies,

7. See, e.g., *Fross v. Wotton*, 3 Cal.2d 384, 44 P.2d 350 (1935).

8. See, e.g., *Menick v. Goldy* 131 Cal. App.2d 542, 280 P.2d 844 (1955).

and the pipes, casks, and tanks in which the wines or brandies are contained, if the transfers are made in writing and executed and acknowledged, and if the transfers are recorded in the book of official records in the office of the county recorder of the county in which the wines, brandies, pipes, casks, and tanks are situated.

(e) The transfer, or assignment, statutory or otherwise, made for the benefit of creditors generally or by any assignee acting under an assignment for the benefit of creditors generally, or to any security agreement made for the benefit of creditors generally.

(f) Property exempt from execution.

(g) Standing timber if the contract or grant in relation to the same is recorded as provided in Section 1220 of this code.

(h) A transfer of personal property if:

(1) Said personal property is leased back to the transferor immediately following said transfer.

(2) The transferor (lessee) or the transferee (lessor) records at least 10 days before the date of the transfer and leaseback in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the intended transfer and leaseback which states the name and address of the transferor (lessee) and transferee (lessor). The notice shall contain a general statement of the character of the personal property intended to be transferred and leased back, and show the date when and place where the transaction is to be consummated.

(3) The transferor (lessee) or the transferee (lessor) publishes a copy of the notice pursuant to Section 6061 of the Government Code in a newspaper of general circulation published in the judicial district in which the personal property is situated, if there is one, and if there is none in the judicial district, then in a newspaper of general circulation in the county embracing the judicial district. The publication shall be completed not less than five days before the date of the intended transfer and leaseback.

(i) Transfers between members of the same household as to personal property within or incident to the household.

This section shall not affect the rights of a secured party who acquires from the transferee or his successor a security interest in the personal property transferred if

1. The intended debtor or secured party records at least 10 days before the consummation of the security agreement in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the transfer and intended security agreement which states the names and addresses of the transferor and transferee and of the intended debtor and secured party. The notice shall contain a general statement of the character of the personal property transferred and intended to be subject to the security interest, and show the date when and place where the security agreement is to be consummated, and

2. The intended debtor or secured party publishes a copy of the notice pursuant to Section 6061 of the Government Code in a newspaper of general circulation published in the judicial district in which the personal property is situated, if there is one, and if there is none in the judicial district, then in a newspaper of general circulation in the county embracing the judicial district. The publication shall be completed not less than five days before the date of the intended security agreement.

Subdivision (2) of Section 2402 of the Commercial Code is not restricted by the provisions of this section.

Comment. Subdivision (1) excepts a transfer of personal property between members of a household from the conclusive presumption of fraud created by Section 3440 where there is no actual and continued change of possession of the property. The exception of inter-household transfers from the conclusive operation of Section 3440 does not affect any inference of fraud that may arise in such a transfer. See, e.g., Menick v. Goldy, 131 Cal. App.2d 542, 280 P.2d 844 (1955) (transfer between parent and child).

STATE OF CALIFORNIA

CALIFORNIA LAW
REVISION COMMISSION

TENTATIVE RECOMMENDATION

relating to

TRANSFER BETWEEN MEMBERS OF HOUSEHOLD AS FRAUDULENT CONVEYANCE

January 1981

Important Note: This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be considered when the Commission determines what recommendation, if any, it will make to the California Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you object to the tentative recommendation or that you believe that it needs to be revised. COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE SENT TO THE COMMISSION NOT LATER THAN JUNE 1, 1981.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

CALIFORNIA LAW REVISION COMMISSION
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