

Memorandum 81-6

Subject: Study D-801 - Creditors' Remedies (Interfamily Transfer as Fraudulent Conveyance)

Civil Code Section 3440 provides that a transfer of personal property is conclusively presumed fraudulent as to creditors if there is no immediate delivery and permanent change of possession of the property. At the November 1980 meeting the Commission decided to recommend that this provision be amended to remove from its operation a transfer of property between members of a household.

Attached to this memorandum is a draft of a tentative recommendation to accomplish the Commission's decision. The draft was prepared by Mr. N.G.T. Rajapakse, Secretary of the Sri Lanka Law Commission. Mr. Rajapakse is currently visiting the office of the California Law Revision Commission to gain experience and to learn the operation of the office.

The Commission should decide if the tentative recommendation is ready to distribute for comment.

Respectfully submitted,

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#D-801

Staff Draft

TENTATIVE RECOMMENDATION

relating to

TRANSFER BETWEEN MEMBERS OF HOUSEHOLD AS FRAUDULENT CONVEYANCE

January 1981

CALIFORNIA LAW REVISION COMMISSION  
4000 Middlefield Road, Room D-2  
Palo Alto, California 94306

## 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,<sup>1</sup> two special 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.<sup>2</sup>

(2) Even if there is delivery and change of possession of the property, the intimate relationship between the parties to the transfer may raise an inference of fraud as to creditors.<sup>3</sup>

The conclusive presumption of fraud created by Civil Code Section 3440 is ill-suited to transfers between members of a household.<sup>4</sup> The main purpose of Section 3440 in requiring an immediate delivery and continuous change of possession is to give notice to creditors.<sup>5</sup> 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 of possession from one member to another of personal property within or incident to the household may not be patent to the rest of the world.

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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).

5. See Joseph Henspring Co. v. Jones 55 Cal. App. 620, 203 Pac. 1038 (1921).

The transfer of personal property between household members tends 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 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 the 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.<sup>6</sup>

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 surrounding the transaction, the relationship, and interest of the parties.<sup>7</sup> 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.<sup>8</sup>

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6. See Bruch, loc. cit.

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).

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:

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, 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.

(1) 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.)