

8/24/81

Memorandum 81-46

Subject: Study D-801 - Transfer Between Members of Household as
Fraudulent Conveyance (Views of State Bar Committees)

At the July 1981 meeting the Commission reviewed comments received on its tentative recommendation relating to transfers between members of the same household as fraudulent conveyances. Existing law conclusively presumes that a transfer of property without an actual and continued change of possession is fraudulent as against creditors. The tentative recommendation makes an exception to the conclusive presumption in the case of a transfer between members of the same household on the basis that such a transfer may in fact be bona fide but an actual and continued change of possession is not possible because all members of the household are presumptively in possession of all property in the household. There is an inference of fraud in a transfer between members of the household and the tentative recommendation relies on this inference. A copy of the tentative recommendation is attached.

The comments received on the tentative recommendation were generally favorable, but there was a split between the State Bar Committee on Administration of Justice (which favored the recommendation) and the Debtor/Creditor Relations and Bankruptcy Subcommittee of the Business Law Section (which opposed the recommendation). The Committee on Administration of Justice took the position that the tentative recommendation is correct--the conclusive presumption can and probably does invalidate bona fide transfers among family members, where an open, notorious change of possession is impossible or impractical. The Committee suggested that the inference of fraud in an intra-family transfer should be codified as a rebuttable presumption of fraud that affects the burden of proof. This suggestion was prompted by the policy considerations that such transfers are suspect and should be examined with care, but those that are bona fide should not be set aside solely because they occur within the confines of a single household.

The Debtor/Creditor Relations and Bankruptcy Subcommittee took the position that interspousal transfers are one of the most common fraudulent conveyances and provide too easy a means of defeating levy of execution. The conclusive presumption is important because it comes into play only when nonexempt "high ticket" items such as automobiles, antiques, and

works of art are being transferred within the family with the effect of defeating creditors. The Subcommittee felt that if there is a need to exempt interspousal transfers from the conclusive presumption of fraud, this should be done in such a way that creditors are not defeated. The Subcommittee suggested a requirement that the spouses remain solvent before and after the transfer and that they give public notice of the transfer in order for the transfer to be exempt from the conclusive presumption of fraud.

The Commission transmitted the views of each of these State Bar committees to the other, with the request that they attempt to reconcile their views. We have received responses from both committees reiterating their positions. See Exhibits 1 (Committee on Administration of Justice) and 2 (Debtor/Creditor Relations and Bankruptcy Subcommittee). The Commission must now decide what action to take on the tentative recommendation.

The staff has taken the position that no change should be made in the conclusive presumption of fraud. First, most intra-family transfers will involve exempt property, which is not subject to the conclusive presumption; the conclusive presumption affects only transfers of valuable items not of the ordinary household sort that we normally wish to protect from creditors. Second, the conclusive presumption is conducive to efficient administration of justice; it avoids litigation and difficult proof problems in a situation where experience is that most of the suspect transfers are in fact made for the purpose of avoiding creditors. Third, there is a simple means for the family members to ensure that the transfer is not voided by creditors: pay their debts. The conclusive presumption is effective to enforce the precept that people should pay their debts; if people are unable to pay their debts, the conclusive presumption provides the creditor a simple means to set aside suspect transfers without resort to complex litigation under other provisions of the Uniform Fraudulent Conveyance Act that enable a creditor to avoid transfers by insolvent debtors.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary



THE COMMITTEE ON
ADMINISTRATION
OF JUSTICE
OF THE STATE BAR OF CALIFORNIA

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July 22, 1981

John H. DeMouilly, Esq.
State of California
Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Dear Mr. DeMouilly:

Thank you for your letter of July 15, 1981 and the enclosed copy of a letter from Alan Pedlar on behalf of the Debtor/Creditor Relations and Bankruptcy Subcommittee of the Business Law Section of the State Bar of California.

As you may be aware, CAJ is in recess over the summer and it would not be practicable to reconvene the Committee for the purpose of obtaining its response to the Business Law Section's views. As a practical matter, the proposal was fully debated by the Committee and the points made by the Business Law Section were considered. This being the case, it is my personal feeling that if presented with the statement of position of the Business Law Section, CAJ would persist in its position as expressed in my letter of June 24, 1981.

The Committee will not reconvene until the latter part of September, at the earliest, and I am afraid that there is not much more that I can do prior to the next meeting of the Commission.

I trust that the foregoing will be sufficient.

Very truly yours,

Robert A. Holtzman

RAH:gc

cc: Monroe Baer, Esq.
Richard Mansfield, Esq.

EXHIBIT 2

BUSINESS LAW SECTION

OF THE STATE BAR OF CALIFORNIA

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July 28, 1981

John H. DeMouilly
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Re: Law Revision Commission Proposal Concerning
Interfamily Transfer as Fraudulent Conveyance

Dear John:

I have reviewed the letter from the State Bar Commission on the Administration of Justice regarding the proposed amendment to Civil Code §3440.

In analyzing this proposal, I believe that it is important for the Commission to focus upon what it is attempting to accomplish. One must start with the proposition that the contemplated exception to Civil Code §3440 is only for "high-ticket" items, because all other property typically owned by spouses is exempt from execution and accordingly not within Civil Code §3440. See §3440(f). Accordingly, one is analyzing transfers of non-exempt personal property, such as automobiles, antiques, and works of art.

Second, one must consider the type of circumstances where such transfers occur between the spouses. Two such circumstances come to mind. The first type occurs in the area of debtor-creditor relations during a period of difficulty between a spouse and his or her creditors. This is the type of voidable transfer envisioned by Civil Code §3440. Such transfers should be presumptably fraudulent.

John H. DeMouilly
July 28, 1981
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The second type of transfer occurs in the area of family law where the purpose of the transfer has nothing to do with debtor-creditor relations. Such a situation could arise as a result of a property settlement agreement between the spouses during the course of the marriage.

If it is the Law Revision Commission's intention to allow spouses to make interspousal transfers in the case of property settlements arising during the marriage (for example, if the spouses no longer wish to hold community property), then a narrow exception to Civil Code §3440 can be carved out. Such an exception should allow a legitimate non-creditor related interspousal transfer, but leave §3440 unaltered with respect to any interspousal transfer which may have been done to defeat a creditor.

I believe that such a proposal was outlined in the final paragraph of the Business Law Section's report on this matter. If it is the Commission's desire to protect legitimate interspousal transfers, we would recommend an exception to §3440 similar to that contained in Civil Code §3440(h). This exception could provide that both spouses would have to be solvent, both before and after the transfer (with the burden of proof on solvency on the spouse), and require public notice of the transfer, such as the filing of a notice of separate property holdings as described in Civil Code §5114.

Under such an exception, if the spouses wish to make an interspousal transfer solely for family law reasons, then they need only be solvent and give public notice of the transfer to exempt it from Civil Code §3440. We continue to believe, however, that the proposed blanket exemption for spousal transfer from §3440 is totally unacceptable, for interspousal transfers remain one of the most common fraudulent conveyances, and provide too easy a means of defeating levy of execution.

Please advise me if you require any further comments on this matter.

Very truly yours,


Alan Pedlar

AP/gjt

cc: Maryellen Mattani
Rich Peters
Robert Holtzman

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
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,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.

(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).