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Intragroup (Upstream, Cross-Stream, and Downstream) Guaranties under the Uniform Fraudulent Transfer Act

Phillip Blumberg
University of Connecticut School of Law

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*Phillip I. Blumberg***

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** Professor of Law and Business and Former Dean, University of Connecticut Law School.

I. INTRAGROUP GUARANTIES IN AN ECONOMIC WORLD OF CORPORATE GROUPS

One of the major sources of the economic strength of the large corporate group, particularly the multinational enterprise, is its ability to direct available group resources to the companies within the group that can earn the highest return for comparable risks and thereby maximize group profits.[1] In brief, the parent corporation typically centralizes and exercises the financial decisionmaking power of the group,[2] acting as an internal capital market by channelling available group resources to the most advantageous investment opportunities available within the group. Such intragroup financing necessarily involves intercompany loans and guaranties.

When lending to enterprises of smaller dimensions, lenders will commonly insist upon guaranties by group affiliates, controlled corporations, or controlling shareholders before they will lend to any com-

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[1] See Landers, Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy, 43 U. Chi. L. Rev. 527, 532 (1976); Landers, A Unified Approach to Parent, Subsidiary and Affiliate Questions in Bankruptcy, 42 U. Chi. L. Rev. 589, 591-92 (1975); Littman, Multiple Intent, Veil-Piercing, and Burdens and Benefits: Fraudulent Conveyance Law and Multiparty Transactions, 39 U. Miami L. Rev. 307, 315 (1985). But see Posner, The Rights of Creditors of Affiliated Corporations, 43 U. Chi. L. Rev. 499, 521-24 (1976).

[2] See A. Rugman, Inside the Multinationals 75-88 (1981).

ponent of the group. This requirement strengthens the borrower's credit and avoids possible intragroup manipulation of its affairs to the lender's detriment. In some cases, such strengthening of the borrower's credit position may also serve the borrower's interests by contributing to the negotiation of a somewhat lower interest rate. In other cases, such guaranties may be required to make the borrowing possible at all.

Intragroup financing also plays an important role in leveraged buyout acquisitions where the assets or credit of the corporation being acquired are utilized for the payment to, or to secure the payment of, the selling shareholders.[3] Although commentators have criticized the application of the fraudulent transfer laws to leveraged buyouts,[4] numerous cases under the Uniform Fraudulent Conveyance Act ("UFCA") and the bankruptcy laws have avoided such transfers when these statutes were otherwise applicable.[5]

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[3] See generally Ash, The Lender, in Leveraged Buyouts 195, 223-34 (P.L.I. Corp. L. & P. No. 393, 1982) (noting that the net effect of leveraged buyouts is benefit to the target's shareholders before the creditor financing the leveraged buyout is benefitted); Coquillette, Guaranty of and Security for the Debt of a Parent Corporation by a Subsidiary Corporation, 30 Case W. Res. 433, 436, 442 (1980) (subsidiary may have difficulty showing required benefit for guaranty of loan to its parent); Douglas-Hamilton, Creditor Liabilities Resulting from Improper Interference with the Management of a Financially Troubled Debtor, 31 Bus. Law. 343, 348-52 (1975) (discussing the problems and liabilities of creditors who participate in the business affairs of their debtors); Normandin, Intercorporate Guaranties and Fraudulent Conveyances, in Personal Property Security Interests under the Revised UCC 361, 386-93 (P.L.I. Comm. L. & P. No. 175, 1977) (bootstrap acquisitions and similar problems); Rosenberg, Fraudulent Conveyance and Preference Implications of Leveraged Acquisitions, in Leveraged Business Acquisitions 147-204 (P.L.I. Corp. L. & P. No. 305, 1979) (general discussion of subject matter).

[4] See Baird & Jackson, Fraudulent Conveyance Law and Its Proper Domain, 38 Vand. L. Rev. 829, 850-54 (1985). But see Carlson, Leveraged Buyouts in Bankruptcy, 20 Ga. L. Rev. 73, 76, 120 (1985) (suggesting the relaxation of fraudulent transfer rules to exclude liability if the lender reasonably believed that the company, although insolvent, had a fair chance to survive).

[5] See, e.g., Branch v. Steph, 389 F.2d 233 (10th Cir. 1968); Credit Managers Ass'n v. Federal Co., 629 F. Supp. 175, 183-88 (C.D. Cal. 1985); Palmer v. Stokely, 255 F. Supp. 674 (W.D. Okla. 1966); *In re* Process-Manz Press, Inc., 236 F. Supp. 333 (N.D. Ill. 1964), rev'd on other grounds, 369 F.2d 513 (7th Cir. 1966), cert. denied, 386 U.S. 957 (1967); Anderson Indus., Inc. v. Anderson (*In re* Anderson Indus., Inc.), 55 Bankr. 922 (Bankr. W.D. Mich. 1985); Rodino v. Barondess (*In re* Good Time Charley's, Inc.), 54 Bankr. 157 (Bankr. D.N.J. 1984); Consove v. Cohen (*In re* Roco Corp.), 15 Bankr. 813 (Bankr. D.R.I. 1981), aff'd in part, vacated in part, 21 Bankr. 429 (Bankr. 1st Cir. 1982), aff'd, 701 F.2d 978 (1st Cir. 1983). See Roxbury State Bank v. The Clarendon, 123 N.J. Super. 400, 303 A.2d 340 (1973), modified, 129 N.J. Super. 358, 373-76, 324 A.2d 24, 32-34 (1974) (construing New Jersey enactment of the UFCA), cert. denied, 66 N.J. 316, 331 A.2d 16 (1974); cf. Ohio Corrugating Co. v. Security Pac. Business Credit, Inc. (*In re* Ohio Corrugating Co.), 70 Bankr. 920, 926 (Bankr. N.D. Ohio 1987) (in denying motion for summary judgment because record was incomplete as to whether debtor received reasonably equivalent value in exchange for transfer at issue, the court held that "as a matter of law [the UFCA] may be applied to leveraged buyouts"); Gough

Intragroup guaranties[6]—downstream,[7] upstream,[8] and cross-stream[9]—play an important role in the financing of corporate groups. An increasing part of the world economy is being conducted by multinational enterprises in the form of groups of companies with structures of "incredible complexity" operating in dozens of countries, through scores, if not hundreds, of subsidiaries.[10] Therefore, the issues of whether such guaranties are valid and enforceable under corporation law, and whether such guaranties or payments honoring them constitute fraudulent transfers under the Uniform Fraudulent Transfer Act ("UFTA"), the UFCA[11] and the Bankruptcy Reform Act of 1978 ("Code")[12] loom large in the commercial world. Whether such guaranties or payments constitute voidable preferences or are subject to equitable subordination under the Code presents ad-

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v. Titus (*In re* Christian & Porter Aluminum Co.), 584 F.2d 326, 335-37 (9th Cir. 1978) (avoiding a transfer of assets and security interest in favor of debtor's purchaser).

6 See P. Blumberg, The Law of Corporate Groups: Problems in the Bankruptcy or Reorganization of Parent and Subsidiary Corporations, Including the Law of Corporate Guaranties 246-83 (1985) [hereinafter Blumberg, Corporate Groups: Bankruptcy].

7 A downstream guaranty is a guaranty by a controlling shareholder of the obligation of a controlled corporation. Within a corporate group, it is the guaranty of the higher-tier company of the obligations of a lower-tier company. In other words, it is the guaranty by the corporate parent of the obligations of a first-tier or lower-tier subsidiary or by a first-tier subsidiary of the obligations of a second-tier or lower-tier subsidiary. It is irrelevant whether the guarantor itself holds the shares of the lower-tier subsidiary or whether a subsidiary does so.

8 An upstream guaranty is a guaranty by a controlled corporation of the obligation of its controlling shareholder, i.e., within the corporate group, the lower-tier subsidiary guarantees the obligations of the parent or of a higher-tier subsidiary.

9 A cross-stream guaranty is a guaranty by one affiliated corporation of another affiliated corporation, i.e., another corporation controlled directly or indirectly by the same controlling shareholder.

10 For tax, accounting, political, or administrative convenience, or to avoid qualification under foreign corporation statutes, the large enterprise today almost universally conducts its business through many subsidiary corporations. The parent and the subsidiaries constitute a corporate group which collectively conducts the business of the enterprise throughout the country and the world. In 1982, the 1,000 largest American industrial corporations had an average of about 50 subsidiaries each. See P. Blumberg, The Law of Corporate Groups: Procedural Problems in the Law of Parent and Subsidiary Corporations § 2.02.1, at 28-29, Tables 5, 6, 7, at 465-70 (1983). Mobil Corporation, an extreme example, has operated in 62 different countries through as many as 525 subsidiaries. See Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 440-41 (1980). In England, British Petroleum operates through more than 1,000 subsidiaries, and Unilever has more than 800. See Hadden, Inside Corporate Groups, 12 Int'l J. Soc. L. 271, 274 (1984). The Swiss multinational, Nestle, S.A., operates in more than 60 countries with 600 subsidiaries. See Impressions 10 (Stouffer Hotel Co., Winter 1985). In some cases, the subsidiaries conduct truly separate businesses, but most often the subsidiary is only a part or a fragment of the larger business of its parent, which is collectively conducted by the various affiliates under common general direction.

11 The UFTA and UFCA will sometimes be collectively referred to as the "Uniform Acts."

12 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985).

ditional issues. This Article explores the UFTA's impact on intragroup guaranties.

II. Enforceability of Upstream and Cross-stream Guaranties under Corporate Law

Before one reaches the question of whether a guaranty otherwise valid may still be avoided as a fraudulent transfer or a voidable preference, one must address the threshold issue of the enforceability of intragroup guaranties, particularly upstream and cross-stream guaranties,[13] under corporation law.[14] Although it would appear that

[13] The source of the difficulty is that in the upstream or cross-stream transaction, the guarantor company has no proprietary interest in the affiliate whose obligation is being guaranteed. In the case of the downstream guaranty, the parent corporation (or other upper-tier company) directly or indirectly owns all or a controlling block of the shares of the lower-tier subsidiary whose obligation it is guaranteeing. By reason of such proprietary interest, the economic benefit to the parent-guarantor is evident. In addition, in the case of economically integrated corporate groups, the guarantor's interests are furthered by assistance to its affiliated customer or supplier. E.g., General Inv. Co. v. Bethlehem Steel Corp., 248 F. 303 (D.N.J. 1918); *In re* New York Car Wheel Works, 141 F. 430 (W.D.N.Y. 1905); Alliegro v. Pan Am. Bank, 136 So. 2d 656 (Fla. Dist. Ct. App. 1962), cert. denied, 149 So. 2d 45 (Fla. 1963); American Sur. Co. v. 14 Canal St., Inc., 276 Mass. 119, 125-26, 176 N.E. 785, 788 (1931); State Bank v. Pacific Elevator Co., 159 Minn. 94, 198 N.W. 304 (1924); Jesselsohn v. Boorstein, 111 N.J. Eq. 310, 162 A. 254 (1932); Baker v. Edson Hotel Operating Co., 99 S.W.2d 998 (Tex. Civ. App. 1936); cf. Commercial State Sav. Bank v. Bird, 254 Mich. 418, 237 N.W. 57 (1931) (controlling shareholder).

[14] See generally Alces, The Efficacy of Guaranty Contracts in Sophisticated Commercial Transactions, 61 N.C.L. Rev. 655, 676-83 (1983) (where statutes and case law tend to favor guarantors, the author suggests that creditors' counsel can, through careful drafting, do much to assure the validity of the guaranty contract); Cherin, Ash, & Burlingame, Enforceability of Guarantees and Other Credit Support Provided Among Members of a Corporate Group: A Bibliography, 34 Bus. Law. 2029 (1979) (bibliography of sources discussing fraudulent conveyance law, equitable subordination and "piercing the corporate veil"); Coquillette, supra note 3 (suggesting precautions which can be taken so that upstream guaranties will be valid, binding and enforceable); Dwyer, A Legal and Business Examination of the Contractually Supported Investment in Relation to the Corporate Guaranty, 23 Syracuse L. Rev. 33 (1972) (in today's complex business world, a contractually supported investment may be more attractive than a corporate guaranty); Everdell & Longstreth, Some Special Problems Raised by Debt Financing of Corporations under Common Control, 17 Bus. Law. 500, 501 (1962) ("there are likely to be few legal roadblocks in the way of sister corporation financing that a little imagination and ingenuity in the construction of the terms of the transaction and preparation of the instruments cannot effectively avoid"); Kreidmann, The Corporate Guaranty, 13 Vand. L. Rev. 229 (1959) (study of the effects of recent legislation regarding corporate guaranties); Ragusin, Brother-Sister Corporate Guaranties: Increased Legal Acknowledgement of Business World Realities, 11 J. Corp. L. 391 (1986) (review and update of the issues underlying enforceability of cross-stream guaranties); Rosenberg, Intercorporate Guaranties and the Law of Fraudulent Conveyances: Lender Beware, 125 U. Pa. L. Rev. 235 (1976) (analysis of the application of fraudulent conveyance law to intracorporate guaranty agreements); Note, Upstream Financing and Use of the Corporate Guaranty, 53 Notre Dame L. Rev. 840 (1978) [hereinafter Note, Upstream Financing] (although there has been liberalization in the courts' interpretation of corporate powers and their enforcement of guaranties in general, upstream guaranties have received little judicial attention); Note, The Corporate Guaranty Revisited: Upstream, Down-

this question has, for the most part, been long since resolved, some corporate counselors are still concerned that the enforceability of such guaranties under corporation law is not completely clear, at least for purposes of issuing opinion letters.[15]

As in so many other areas in the law of corporate groups, the problem of intragroup guaranties arises primarily from the conflict between managerial direction of the group in the interest of the enterprise as a whole and legal doctrines that have traditionally insisted on the recognition of each corporate component of the enterprise as a separate legal entity.[16] Thus, in order to achieve profit maximization for the enterprise as a whole, the parent's managers will typically wish to structure the group's credit transactions in a way that will optimally exploit the credit-worthiness of its stronger components. In addition, management should attempt to allocate the resources obtained to the most promising investment opportunities within the group. As a result, the subsidiary that is the guarantor or borrower in a financing is often pledging its credit to raise funds for the use of an affiliate rather than for its own use. This situation gives rise to the concern under the corporate law.

The corporate law problem traditionally involves two issues: corporate power and corporate object. The initial question is whether the corporation has the power to issue a guaranty under any circumstances. After the question of corporate power has been resolved, a further question arises: Whether the issuance of a guaranty in the particular case furthers the guaranteeing corporation's objectives and interests.

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stream, and Beyond—A Statutory Approach, 32 Rutgers L. Rev. 312 (1979) [hereinafter Note, Guaranty Revisited] (suggesting a statutory approach to the enforceability of corporate guaranties, especially where a corporation guarantees the obligations of another corporation); Note, Guarantees and Section 548(a)(2) of the Bankruptcy Code, 52 U. Chi. L. Rev. 194, 194-95 (1985) [hereinafter Note, Section 548(a)(2)] (discussing "circumstances in which a guarantee given by a guarantor who has become a debtor in bankruptcy can be set aside as a fraudulent conveyance under section 548(a)(2) of the . . . Code"); Note, "Ultra Vires" Corporate Credit Transactions, 83 U. Pa. L. Rev. 479, 480-92 (1935) (discussing extension of a corporation's credit for benefit of some third person).

15 See Note, Guaranty Revisited, supra note 14, at 312-23; cf. Witt, Corporate Guaranties, The Quest for Legislative Clarification, 36 Tex. B.J. 907, 912-14 (1973) (discussing amendment of Texas' corporation law with regard to guaranties).

16 This fundamental dilemma frames the legal questions throughout the entire spectrum of the law of corporate groups. See P. Blumberg, The Law of Corporate Groups: Procedural Problems in the Law of Parent and Subsidiary Corporations (1983); P. Blumberg, Corporate Groups: Bankruptcy, supra note 6; P. Blumberg, The Law of Corporate Groups: Tort, Contract, and Other Common Law Problems in the Substantive Law of Parent and Subsidiary Corporations (1987).

A. *Corporate Power*

The question of corporate power is a problem of yesteryear. The statutes of almost all states have long since resolved this issue by express grants of the power to guarantee.[17] In addition, the Model Business Corporation Act includes a like provision.[18] In the few jurisdictions without such statutes,[19] the inclusion of a power to guarantee in the certificate of incorporation, or even the implication of such a power from more general powers in the certificate, should end the inquiry.[20] Finally, in isolated cases, even if a question still remains, the statutes and judicial doctrines that restrict the assertion of ultra vires to a narrowly circumscribed class of cases[21] should, in most cases, foreclose the matter.

B. *Corporate Objects*

Corporate common law generally assumes that corporate powers, however indisputable, may only be invoked in furtherance of corporate objectives.[22] Further, in the case of an accommodation guaranty, the gratuitous nature of the undertaking presents a possible violation of the related rule that a corporation may not give away any portion of its assets without unanimous consent.[23] Therefore, to satisfy the corporate common law, it is necessary only that the guaranty further the corporate interests of the guarantor corporation, whereas formerly, a showing that the guarantor was directly benefitted by the guaranty was required.[24]

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17 Alabama, Alaska, North Dakota, South Dakota, and the District of Columbia are the only jurisdictions without such statutes. See P. Blumberg, Corporate Groups: Bankruptcy, supra note 6, § 6.02, at 249 n.3.

18 Model Business Corp. Act. Ann. § 3.02(7) (1984 & Supp. 1986) ("Unless its articles of incorporation provide otherwise, every corporation ... has the same powers as an individual to do all things necessary to carry out its business and affairs, including without limitation power: ... (7) to make ... guarantees."). Section 4(h) of the earlier Model Act provided that "[e]ach corporation shall have power ... to make ... guarantees." Id. § 4(h) (1971).

19 See supra note 17.

20 See N. Lattin, The Law of Corporations 206 (2d ed. 1971).

21 See 7A W. Fletcher, Cyclopedia of the Law of Private Corporations §§ 3495-3497, 3527-3528, 3555-3562, at 119-24, 151-53, 168-76 (rev. perm. ed. 1978); H. Henn & J. Alexander, Laws of Corporations and Other Business Enterprises § 184, at 477-84 (3d ed. 1983); see also Model Business Corp. Act. § 3.04, at 226-37 (Supp. 1987) (ultra vires provision, official comment and annotation, including historical background of ultra vires). All states have enacted such statutes. Hawaii, for many years the only holdout, has at last done so. Haw. Rev. Stat. § 415-7 (1985).

22 See Real Estate-Land Title & Trust Co. v. Commonwealth Bond Corp., 63 F.2d 237, 238-39 (2d Cir. 1933).

23 See 6 W. Fletcher, supra note 21, § 2589, at 670-72 (rev. perm. ed. 1979).

24 See Kreidmann, supra note 14, at 232-34; Note, Upstream Financing, supra note 14, at 842-44.

Over the years, however, the standard has expanded from the restricted direct-benefit test to a much more liberal test resting on reasonable business judgment.[25] The commentary to the 1971 draft of the Model Business Corporation Act concluded: "Guaranties should be upheld if it is shown that the board of directors of the guarantor had in good faith, and in the exercise of reasonable business judgment, decided that the benefits derived from the guaranties were sufficient to justify the liability incurred."[26] Further, where there was unanimous shareholder consent, judicial decisions have upheld the enforceability of intergroup guaranties, notwithstanding contentions that the guaranties were not in pursuance of the guaranteeing corporation's corporate purposes.[27] Accordingly, in the case of wholly owned subsidiaries, the parent's readily available consent would remove any question of the validity of an upstream or cross-stream guaranty.[28]

The courts have overwhelmingly upheld the validity under corporation law of upstream,[29] and cross-stream,[30] as well as downstream guaranties.[31] Numerous jurisdictions have also adopted

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25 See *Real Estate-Land Title & Trust Co.*, 63 F.2d at 238-39.

26 1 Model Business Corp. Act Ann. § 4(h) (2d ed. 1971).

27 E.g., Libco Corp. v. Leigh (*In re* Reliable Mfg. Corp.), 703 F.2d 996, 1003 (7th Cir. 1983); New England Merchants Nat'l Bank v. Lost Valley Corp., 119 N.H. 254, 400 A.2d 1178 (1979).

28 The corporation owes no duty to creditors where it is not insolvent or imminently facing insolvency. See Blumberg, Corporate Groups: Bankruptcy, supra note 6, § 6.13, at 280-82 (1985); Baxt, Companies—Extent of Duty Owed by Directors of a Company to Its Creditors and Others, 60 Austl. L.J. 102 (1986).

29 E.g., Manufacturers & Traders Trust Co. v. Goldman (*In re* Ollag Constr. Equip. Corp.), 578 F.2d 904, 906-07 (2d Cir. 1978); Cate v. Nicely (*In re* Knox Kreations, Inc.), 474 F. Supp. 567 (E.D. Tenn. 1979), aff'd in part, rev'd in part, 656 F.2d 230 (6th Cir. 1981); New England Merchants Nat'l Bank v. Lost Valley Corp., 119 N.H. 254, 400 A.2d 1178 (1979); Lochsley Hall Inc. v. Filmvideo Releasing Corp., 36 A.D.2d 694, 318 N.Y.S.2d 864 (1971) (per curiam); Hayman v. Morris, 46 N.Y.S.2d 482 (Sup. Ct. 1943). But cf. Jackson v. M.H. Thomas Inv. Co., 46 F.2d 252 (5th Cir. 1931) (guaranty by a corporation of its controlling shareholder's personal obligation would have been enforced but for the existence of creditors of the corporation; the court held that claim of shareholder's creditor in whose favor the corporate guaranty was made was subordinate to those of corporation's primary creditors).

30 Gotshal v. Mill Factors Corp. (*In re* Gartner Importing Corp.), 289 F. 1005 (2d Cir. 1923); *In re* Duncan & Goodell Co., 15 F. Supp. 550 (D. Mass. 1936); Power County v. Evans Bros. Land & Live Stock Co., 43 Idaho 158, 252 P. 182 (1926); American Union Fin. Corp. v. University Nat'l Bank, 44 Ill. App. 3d 566, 358 N.E.2d 646 (1976); Stromberg-Carlson Tel. Mfg. Co. v. George C. Beckwith Co., 193 Minn. 255, 258 N.W. 314 (1935); McCarty v. Nostrand Lumber Co., 232 A.D. 63, 248 N.Y.S. 606 (1931); Empire Steel Corp. v. Omni Steel Corp., 378 S.W.2d 905 (Tex. Ct. App. 1964). Cf. *In re* First Nat'l Bank v. Retirement Ranches, Inc., 90 N.M. 546, 566 P.2d 95 (1977) (apparent cross-stream guaranty upheld as valid; the court characterized debtor corporation as a "related corporation;" therefore, unclear whether guaranty was, in actuality, cross-stream).

31 Central R.R. & Banking Co. v. Farmers' Loan & Trust Co., 114 F. 263 (C.C.A.N.Y.), cert. denied, 186 U.S. 482 (1902); Eckhout v. Guardian Nat'l Bank (*In re* Battani), 6 F. Supp. 376 (E.D. Mich. 1934); Henderson Tire & Rubber Co. v. Gregory, 16 F.2d 589 (8th Cir. 1926);

statutes dealing with the validity of such guaranties. For example, North Carolina prohibits upstream guaranties of any majority shareholder's obligations.[32] California authorizes a corporate guaranty of the obligations of *any* shareholder upon approval by a majority of the shareholders, with the interested shareholder barred from voting.[33] Such restrictive statutes, however, are the exception.

Most statutes confirm, or prescribe the procedure for confirming, the validity of intragroup guaranties. New York,[34] New Jersey,[35] and Rhode Island[36] have enacted statutes confirming the validity of intragroup guaranties, even though not issued in furtherance of corporate purposes, if the guaranty has been approved by a majority or two-thirds of the shareholders.

Minnesota authorizes corporations to issue guaranties for the benefit of majority-owned related corporations.[37] Its statute contains no references regarding benefit to the guarantor. However, the reporter's note clearly indicates that transfers of funds within the corporate group are regarded as being in the interests of each affiliate of the group. "The ability to bolster the finances of a related corporation . . . is important because these related corporations are often part of one economic unit within which artificial distinctions should not prevent internal transfers of funds."[38] Washington has authorized the issuance of upstream and cross-stream guaranties "if such guarantee may reasonably be expected to benefit, directly or indirectly, the guarantor

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Federal Reserve Bank v. Pacific Grain Co., 2 F.2d 270 (D. Or. 1924); General Inv. Co. v. Bethlehem Steel Corp., 248 F. 303 (D.N.J. 1918); *In re* New York Car Wheel Works, 141 F. 430 (W.D.N.Y. 1905); Alliegro v. Pan Am. Bank, 136 So. 2d 656 (Fla. Dist. Ct. App.), cert. denied, 149 So. 2d 45 (Fla. 1962); Kelley, Glover & Vale, Inc. v. Heitman, 220 Ind. 625, 44 N.E.2d 981 (1942), cert. denied, 319 U.S. 762 (1943); American Sur. Co. v. 14 Canal St., Inc., 276 Mass. 119, 176 N.E. 785 (1931); State Bank v. Pacific Elevator Co., 159 Minn. 94, 198 N.W. 304 (1924); Jesselsohn v. Boorstein, 111 N.J. Eq. 310, 162 A. 254 (1932); Ellerman v. Chicago Junction Rys. & Union Stock-Yards, 49 N.J. Eq. 217, 23 A. 287 (1891); Chester Airport, Inc. v. Aeroflex Corp., 37 Misc. 2d 145, 237 N.Y.S.2d 752 (1962), modified and aff'd per curiam, 18 A.D.2d 998, 238 N.Y.S.2d 715 (1963); Nurick v. Baker, 14 N.Y.S.2d 503 (Sup. Ct. 1939); Baker v. Edson Hotel Operating Co., 99 S.W.2d 998 (Tex. Civ. App. 1936); Ingram v. Texas Christian Univ., 196 S.W. 608 (Tex. Civ. App. 1917).

32 N.C. Gen. Stat. § 55-22(a)(3) (1982).

33 Cal. Corp. Code § 315 (West 1977 & Supp. 1987). However, courts have construed the California statute to permit upstream guaranties only with the approval of 100% of the shareholders. See 1 H. Marsh, Jr., California Corporation Law § 10.15, at 614-17 (2d ed. 1984); see, e.g., Cechettini v. Consumer Assocs., 260 Cal. App. 2d 295, 67 Cal. Rptr. 15 (1968) (construing prior law).

34 N.Y. Bus. Corp. Law § 908 (McKinney 1986) (two-thirds).

35 N.J. Stat. Ann. § 14A:3-3 (West Supp. 1987) (two-thirds).

36 R.I. Gen. Laws § 7-1.1 to 4.2 (1985) (majority).

37 Minn. Stat. Ann. § 302A.501(1)(b) (West 1985). See also id. § 302A.011 (21), (25), (31) (definitions).

38 Id. § 302A.501.

corporation."[39] Since the statute goes on to make the decision of the board of directors as to such benefit binding, it has effectively eliminated any question as to validity.

Texas has approved the issuance of downstream, upstream and cross-stream guaranties without regard to direct or indirect benefit to the guaranteeing affiliate where the companies are wholly owned.[40] In 1983 and 1985, Delaware enacted statutes confirming the validity of upstream and cross-stream guaranties by wholly owned subsidiaries, while keeping open for common law decision the circumstances under which such guaranties by partly owned subsidiaries were valid.[41]

These statutes represent a collective judgment as to the commercial usefulness of intragroup guaranties and the desirability of the elimination of any remaining uncertainty as to their enforceability as a matter of corporation law. Further, such an expression of public policy is bound to influence the decisions of courts facing the question as a common-law matter.[42]

Other common-law jurisdictions have moved in the same direction. In the United Kingdom, for example, The Companies Act expressly authorizes corporate upstream and downstream guaranties.[43] Where the power to guarantee has been expressly provided, the English courts appear to have moved beyond the distinction between power and object to uphold intergroup guaranties.[44] Thus, the *Charterbridge Corp. v. Lloyd's Bank, Ltd.*[45] case held that so long as a cross-stream guaranty furthered the "interests of the individual [guaranteeing] company in relation to the group as a whole," it was not ultra vires, irrespective of the subjective intentions of the controlling

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39 1984 Wash. Laws, ch. 75, § 2(9).

40 Tex. Rev. Civ. Stat. Ann. art. 1302-2.06(A)-(C) (Vernon 1980 & Supp. 1987).

41 Del. Code Ann. tit. 8, § 122(13) (Supp. 1986).

42 Cf. Conference Center Ltd. v. TRC—The Research Corp., 189 Conn. 212, 224-25, 455 A.2d 857, 863 (1983) (using UCC provisions regarding unconscionable terms in contracts for sale of goods to support decision with regard to foreclosure proceeding on a mortgage note); Hamm v. Taylor, 180 Conn. 491, 494-95, 429 A.2d 946, 948 (1980) (same).

43 The Companies Act, 1980, ch. 22, § 50(1), (4), superseded by The Companies Act, 1985, ch. 6, § 333.

44 See Rolled Steel Prods. (Holdings) Ltd. v. British Steel Corp., [1982] 3 All E.R. 1057 (Ch. 1981), rev'd in part C.A., [1985] 3 All E.R. 52; Re Horsly & Weight Ltd., [1982] 3 All E.R. 1045 (C.A. 1980); Re Halt Garage (1964) Ltd., [1982] 3 All E.R. 1016 (Ch. 1978); Charterbridge Corp. v. Lloyd's Bank Ltd., [1969] 2 All E.R. 1185 (Ch. 1968); Aldwinckle, Corporate Law—New Developments—United Kingdom, 11 Int'l Bus. Law. 46 (Dec. 1983); Clark, Ultra Vires after Rolled Steel Products, 6 Co. Law. 155 (1985); Editorial, Acts Ultra Vires the Company and Acts Ultra Vires the Directors, 1984 J. Bus. L. 296; Comment, Objects and Powers in Company Law, 10 Sydney L. Rev. 405 (1984).

45 [1969] 2 All E.R. 1185 (Ch. 1968).

director.[46]

The Canadian Business Corporations Act[47] and related Canadian provincial statutes also expressly authorize upstream and cross-stream guaranties by wholly owned subsidiaries. These statutes authorize such guaranties by a wholly owned subsidiary even in cases where the guaranteeing affiliate is insolvent.[48]

In summary, despite the lingering concern of some commentators,[49] the validity and enforceability of cross-stream and upstream guaranties under corporation law no longer presents important questions within the corporate group. In light of the economic interdependence of the group's component companies and the interest of each component in strengthening the overall economic condition of the group of which it is an integral part, the utilization of group financing involving intercompany guaranties should be recognized as the very sort of decision that should be left to the business judgment of the corporate decisionmakers. Creditors have the protection of the provisions of the Uniform Acts under state law and the Code in the event of bankruptcy. With this preface on corporation law, this Article considers the status of upstream and cross-stream guaranties under the UFTA and, in particular, under those provisions that depart from the provisions of the UFCA or the Code.[50]

III. THE INTERRELATIONSHIP OF THE UNIFORM FRAUDULENT TRANSFER ACT AND THE BANKRUPTCY CODE

The draftsmen of the UFCA generally followed the National Bankruptcy Act ("Bankruptcy Act"), as amended.[51] In the area of fraudulent transfers, the provisions of the two statutes were generally

46 See Parkinson, Non-Commercial Transactions and the Interests of Creditors, 5 Co. Law. 55, 56-59 (1984).

47 Can. Bus. Corp. Act, Can. Stat. ch. 33 (1974-75-76).

48 Id. § 42(2)(c). See Alberta Bus. Corp. Act, Alta. Stat. ch. B-15, § 42 (1981); Ontario Bus. Corp. Act., Ont. Stat. ch. 4, § 20 (1982). See also Karvellas & Daniel, Limitations on the Power of an Alberta Corporation to Provide Guaranties and Other Financial Assistance: Section 42 of the (Alberta) Business Corporations Act, 23 Alta. L. Rev. 479 (1985).

49 See Alces, supra note 14, at 655, 676-83; Ash, The Lender, in Leveraged Acquisitions-Public and Private 85, 94 (P.L.I. Corp. L. & P. No. 436, 1984) (should be avoided); Rosenberg, supra note 14, at 257 (lender "should not rely upon the enforceability of such" guaranties); Note, Upstream Financing, supra note 14, at 847, 860 (much more feasible but the law is far from predictable); Note, Guaranty Revisited, supra note 14, at 321-27 (predictability tenuous). Not all commentators are so cautious. See, e.g., Coquillette, supra note 3, at 445 ("[i]f due precautions are taken, corporate authority should exist" (footnote omitted)).

50 Other than in the context of upstream and cross-stream guaranties, the provisions of the Code are beyond the scope of this Article.

51 11 U.S.C. §§ 1-1255 (1976) (repealed 1978).

in harmony, even utilizing the same terms of art.[52] When Congress completed its review of the bankruptcy laws and enacted the Code,[53] the provisions of the Code that departed from those of the Bankruptcy Act inevitably conflicted with those of the UFCA that had been modeled after the Act. As a result, there were a number of important areas in which the provisions of the two, including those provisions pertaining to fraudulent transfers, were no longer in agreement.

The National Conference of Commissioners on Uniform State Laws moved promptly to deal with this lack of consistency by promulgating the UFTA. Most, although not all, of the UFTA's more important innovations (that is, departures from the UFCA) are derived from the Code, and the UFTA should be viewed as an effort generally, but not universally, to harmonize the state statutes with the Code.[54] Only in isolated cases does the UFTA materially differ from the Code. The following sections discuss these material differences and the significant departures from the UFCA that the UFTA introduces with respect to the treatment of upstream and cross-stream guaranties.

IV. THE UNIFORM FRAUDULENT TRANSFER ACT AND INTRAGROUP GUARANTIES

Four UFTA provisions represent significant departures from the UFCA with respect to the treatment of guaranties, particularly up-

52 For example, compare 11 U.S.C. § 107d(3) (1976) (repealed 1978) which provided that "[e]very transfer made and every obligation incurred by a debtor who is or will thereby be rendered insolvent . . . is fraudulent, as to then existing and future creditors" with U.F.C.A. § 4, 7A U.L.A. 474 (1985), which provides that "[e]very conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors".

53 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985). See generally P. Blumberg, Corporate Groups: Bankruptcy, supra note 6, at 285-362 (review of statutory framework underlying fraudulent transfer provisions contained in the Code and the UFCA); Carl, Fraudulent Transfer Attacks on Guaranties in Bankruptcy, 60 Am. Bankr. L.J. 109 (1986) (applicability of fraudulent transfer law to guaranties and grants of security interests made by affiliated corporations); Coquillette, supra note 3 (whether guaranties and security interests can be valid, binding and enforceable against a subsidiary); Littman, supra note 1 (uncertainty of enforcement of intercorporate guaranties and of security interests in multiparty transactions); Ragusin, supra note 14 (cross-stream guaranties and the Code); Rosenberg, supra note 14 (effect of fraudulent conveyance provisions in both the UFCA and the Bankruptcy Act on intracorporate guaranties).

54 See generally Alces & Dorr, A Critical Analysis of the New Uniform Fraudulent Transfer Act, 1985 U. Ill. L. Rev. 527 (how the Code and UFTA adjust rights of parties affected by certain fraudulent transactions); Kennedy, The Uniform Fraudulent Transfer Act, 18 U.C.C. L.J. 195 (1986) (reporter's step-by-step guide to the UFTA).

stream and cross-stream guaranties, and raise new issues pertaining to the rights of creditors:

(1) The removal of a possible uncertainty with respect to the valuation of guaranties in determining the liabilities of a transferor for purposes of determining its "insolvency" or whether it has received "reasonably equivalent value" in the UFTA's definitions of "asset" and "claim" in sections 1(2)[55] and 1(3).[56]

(2) The characterization in section 5(b) of certain "insider" preferential transactions as fraudulent transfers,[57] subject to certain defenses and limitations of liability with respect to insider transfers specified in section 8(f).[58]

(3) The establishment in section 6(5) of a new standard for determining the time that an "obligation," such as a guaranty, is incurred for purposes of the limitation periods governing UFTA-created rights and remedies.[59]

(4) The adoption in section 9 of specified limitation periods for commencing actions under the UFTA.[60]

A. *Revised Definitions of "Asset" and "Claim"*

In its definitions of "asset" and "claim" in sections 1(2) and 1(3),[61] the UFTA removes a question that had been raised under the UFCA (and the Bankruptcy Act) by some commentators regarding the valuation of the liability represented by a guaranty for purposes of determining "insolvency" and "reasonably equivalent value."[62] The

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55 U.F.T.A. § 1(2), 7A U.L.A. 644 (1985) (providing, subject to certain exceptions, that " '[a]sset' means property of a debtor.").

56 Id. § 1(3) (" 'Claim' means a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.").

Unfortunately, the UFTA's definitions of "asset" and "claim" leave another area which was uncertain under the UFCA still unresolved. See infra notes 85-86 and accompanying text.

57 7A U.L.A 657 (1985). Section 5(b) is the counterpart to section 547(b)(4) of the Code. See 11 U.S.C. § 547(b)(4) (1982 & Supp. III 1985) (certain transfers from "insiders" are voidable preferences in bankruptcy); see also infra text accompanying note 94 (UFTA's definition of "insider").

58 7A U.L.A. 662-63 (1985). See infra notes 122-25.

59 U.F.T.A. § 6(5), 7A U.L.A. 658-59 (1985).

60 Id. § 9, 7A U.L.A. 665.

61 See supra notes 55-56.

62 Compare Rosenberg, supra note 14, at 256-57 (a discount to reflect the likelihood of the guaranty "besides doing violence to the statutory language" would add "another element of uncertainty"); 2 H. Marsh, Jr., supra note 33, § 15.31, at 382-85; Nelson, Complex Leveraged Transactions, in Leveraged Buyouts 275, 282 (P.L.I. Corp. L. & P. No. 393, 1982) ("full amount of the guaranty is considered a liability") with Conner, Enforcing Commercial Guaranties in Texas: Vanishing Limitations, Remaining Questions, 12 Tex. Tech L. Rev. 785, 806-

UFCA's definitions left the door open for interpretations that could have seriously restricted the role of guaranties in financing.

As to creditors existing at the time of the transfer, "insolvency" is the principal, although not exclusive,[63] standard under UFTA sections 5(a)[64] and (b)[65] for determining whether a transferor's financial condition is such that a transfer otherwise falling within the UFTA or the Code is fraudulent for purposes of the statute.[66] Under the UFTA, "[a] debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation."[67] This standard differs from the UFCA in two respects. In valuing assets, the UFCA refers to "present fair salable value,"[68] while the UFTA refers to "fair valuation."[69] In computing liabilities, the UFCA refers to "probable liability on . . . existing debts as they become absolute and matured,"[70] whereas the UFTA eliminates "probable liability," and contains an expanded, inclusive definition of a "claim" against the debtor's estate.[71]

The issues arising under the UFCA and the Bankruptcy Act on the valuation of guaranties for purposes of determining "insolvency" were twofold. First, whether the guarantor's right of subrogation to the creditor's rights against the primary obligor (or to any collateral securing the obligation) and the guarantor's right to contribution

07 (1981) (some commentators support the approach of "crafting reasonable discounts or asserting the present 'value' of subrogation rights").

There is a middle ground: if the guaranty is taken at full value, allowance must be made for the rights of subrogation and contribution. See Wingert v. President Directors & Co., 41 F.2d 660, 662-63 (4th Cir.), cert. denied, 282 U.S. 871 (1930).

63 UFTA § 4(a)(2)(i) applies where the debtor "was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction." U.F.T.A. § 4(a)(2)(i), 7A U.L.A. 653 (1985). Section 4(a) applies where the debtor "intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due." Id. § 4(a). Section 4(a)(2) also requires that "the debtor made the transfer or incurred the obligation . . . without receiving a reasonably equivalent value in exchange for the transfer or obligation." Id. § 4(a)(2), 7A U.L.A. 652-53.

64 Id. § 5(a), 7A U.L.A. 657.

65 Id. § 5(b).

66 Actual intent "to hinder, delay, or defraud," id. § 4(a)(1), 7A U.L.A. 652, or "engag[ing] in a business or a transaction for which the remaining assets . . . were unreasonably small," id. § 4(a)(2)(i), 7A U.L.A. 653, or "intend[ing] to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due," id. § 4(a)(2)(ii), are supplemental standards applicable to future, as well as present, creditors.

67 Id. § 2(a), 7A U.L.A. 648.

68 U.F.C.A. § 2(1), 7A U.L.A. 442 (1985).

69 U.F.T.A. § 2(a), 7A U.L.A. 648 (1985).

70 U.F.C.A. § 2(1), 7A U.L.A. 442 (1985).

71 U.F.T.A. § 1(3), 7A U.L.A. 639, 644 (1985). See supra note 56.

from any co-guarantors were to be regarded as assets to be valued and set off against the liability under the guaranty.[72] Second, whether in determining the liabilities of a transferor, a guaranty should be listed as a liability in the full amount of the indebtedness that it guaranteed, or whether it should be listed in a lesser amount that recognized its contingent nature and reflected an estimate of the probability that the guarantor would be required to honor the guaranty.[73]

1. Rights of Subrogation and Contribution

Numerous cases under the UFCA and the Bankruptcy Act, of which *Manufacturers & Traders Trust Co. v Goldman (In re Ollag Construction Equipment Corp.)*[74] is the leading example, have held that the guarantor's subrogation and contribution rights were to be considered as assets in determining the solvency of a guarantor at the time of issuing a guaranty.[75] In an analogous area, decisions under the Code have concluded that the debtor-guarantor's right of subrogation against a solvent obligor could constitute "reasonably equivalent value" for purposes of determining whether the transfers were fraudulent under section 548 of the Code.[76] Nevertheless, other cases had listed guaranties in the full principal amount without any deduction for possible offsets for the rights of subrogation or contribution.[77] In

72 See infra notes 74-80 and accompanying text.

73 See infra notes 81-86 and accompanying text.

74 578 F.2d 904 (2d Cir. 1978).

75 Manufacturers & Traders Trust Co. v. Goldman (*In re* Ollag Constr. Equip. Corp.), 578 F.2d 904 (2d Cir. 1978) (subrogation and contribution); Syracuse Eng'g Co. v. Haight, 97 F.2d 573 (2d Cir. 1938) (subrogation); Updike v. Oakland Motor Car Co., 53 F.2d 369 (2d Cir. 1931) (subrogation to collateral); Wingert v. President Directors & Co., 41 F.2d 660 (4th Cir.) (subrogation and contribution), cert. denied, 282 U.S. 871 (1930); *In re* Bowers, 215 F. 617 (N.D. Ga. 1914) (right to contribution). See 2 Collier on Bankruptcy ¶ 101.31, at 101-54.12 to 101-54.13 (L. King 15th ed. 1987); Carl, supra note 53, at 129-34; Walls, Promises to Keep: Intercorporate Guarantees and Fraudulent Transfers in Bankruptcy, 19 U.C.C. L.J. 219, 240-42 (1987); cf. Schwartz v. Commissioner, 560 F.2d 311, 317 (8th Cir. 1977) (Internal Revenue Code).

76 Emerald Hills Country Club, Inc. v. Hollywood, Inc. (*In re* Emerald Hills Country Club, Inc.), 32 Bankr. 408, 420 (Bankr. S.D. Fla. 1983); Howco Leasing Corp. v. Alexander Dispos-Haul Sys., Inc. (*In re* Alexander Dispos-Haul Sys., Inc.), 36 Bankr. 612, 616 (Bankr. D. Or. 1983); *In re* Nelsen, 24 Bankr. 701, 702 (D. Or. 1982). Cf. Join-In Int'l (U.S.A.) v. New York Wholesale Distribs. Corp. (*In re* Join-In Int'l (U.S.A.)), 56 Bankr. 555, 560 (Bankr. S.D.N.Y. 1986) (all factors of a transaction must be considered); Barr v. Weber (*In re* Carousel Candy Co.), 38 Bankr. 927, 937 (Bankr. E.D.N.Y. 1984) (where defendant's attorneys were aware of, and ignored, the existence of creditors, they were "insiders," and the transfer, made when the debtor was insolvent, was deemed fraudulent). But cf. Ear, Nose & Throat Surgeons, Inc. v. Guaranty Bank & Trust Co. (*In re* Ear Nose & Throat Surgeons, Inc.), 49 Bankr. 316, 320 (Bankr. D. Mass. 1985) (where debtor was rendered insolvent by the transactions in question, creditor-bank could set aside debtor's guaranty of its president's loan and security agreement).

77 E.g., Huttig Mfg. Co. v. Edwards, 160 F. 619 (8th Cir. 1908); Moister v. Waters (*In re*

addition, a leading commentator contended that treatment of the subrogation right as a contingent asset was unrealistic.[78]

The UFTA has brought this debate to an end insofar as state law is concerned. In defining an "asset" as "property of a debtor"[79] without regard to whether the property was liable for the debts of the debtor, the draftsmen of the UFTA made it plain that contingent claims were to be included as assets. The official comment to section 1(2) states that "a contingent claim of a surety for reimbursement, contribution, or subrogation may be counted as an asset."[80]

2. Discounted Probability

Although under UFCA section 2(1)'s reference to "probable liability,"[81] courts appeared to be under a statutory direction to make some adjustment or discount of the principal amount of a guaranty to reflect the probability of ultimate payment by the primary obligor, the courts have been divided. Some recognize the need for a discount or adjustment when it might be reasonably anticipated that the obligor would be able to pay on maturity.[82] More frequently, however, courts list the guaranty at its full amount without looking into the question of probability.[83] Commentators also disagree on the matter.[84]

Unfortunately, the UFTA does not resolve this controversy. In place of the UFCA's standard of "probable liability," UFTA section 1(3) defines "claim" as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[85] If anything, the elimination of "probable" and the expanded inclusiveness of the UFTA definition weaken the argument for asserting that the probability of payment of the obligation by the primary obligor should support an adjustment or discount in appropriate cases. The matter, however, is not foreclosed, and the debate should continue. Nevertheless, it seems clear, notwithstanding the ul-

Waters), 8 Bankr. 163 (Bankr. N.D. Ga. 1981); Zellerbach Paper Co. v. Valley Nat'l Bank, 13 Ariz. App. 431, 477 P.2d 550 (1970); Marine Midland Bank v. Stein, 105 Misc. 2d 768, 433 N.Y.S.2d 325 (Sup. Ct. 1980).

78 See Rosenberg, supra note 14, at 256.

79 U.F.T.A. § 1(2), 7A U.L.A. 644 (1985).

80 Id. § 1 comment 2, 7A U.L.A. 645 (1985).

81 U.F.C.A. § 2(1), 7A U.L.A. 442 (1985).

82 Cate v. Nicely (*In re* Knox Kreations, Inc.), 474 F. Supp. 567, 571-72 (E.D. Tenn. 1979), aff'd in part, rev'd in part, 656 F.2d 230 (6th Cir. 1981); Ayers v. Harrell, 111 Ga. 864, 36 S.E. 946 (1900) (per curiam).

83 See cases cited supra note 77.

84 See supra note 62.

85 U.F.T.A. § 1(3), 7A U.L.A. 644 (1985).

timate outcome of the meaning to be given to the statutory term, that a guaranty will not be carried as a liability in any amount upon a showing that the underlying obligation has in fact been paid or that the primary obligor was clearly able to meet the obligation.[86] The failure of the UFTA to resolve this matter is a disappointment.

B. *Transfers to "Insiders"*

Guaranties of insider obligations give rise to a series of important problems under the fraudulent transfer provisions of the UFTA and the Code.[87] Two of these problems involve a debtor's issuance of a guaranty or payment pursuant to its guaranty for the benefit of an affiliated obligor: (1) whether the issuance of an upstream or a cross-stream guaranty by a debtor of an obligation of an affiliated obligor constitutes a fraudulent transfer by the debtor-guarantor to the affiliated obligor;[88] and (2) whether the payment by a debtor-guarantor honoring its guaranty of the obligation of an affiliated obligor constitutes a fraudulent transfer by the debtor-guarantor to the affiliated obligor.

Two other problems involve an affiliate's issuance of a guaranty or payment pursuant to its guaranty for the benefit of a debtor-obligor: (1) whether the issuance of an upstream or cross-stream guaranty by one affiliated corporation of the indebtedness of another affiliated debtor-corporation constitutes a fraudulent transfer for the benefit of the debtor; and (2) whether the payment by one affiliated corporation of the obligation of a debtor-affiliate pursuant to its upstream or cross-stream guaranty constitutes a fraudulent transfer for the benefit of the debtor.

The final problem relates to the status of an unrelated creditor that is the recipient of a fraudulent intragroup transfer: Whether the

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86 Cf. Moister v. Waters (*In re* Waters), 8 Bankr. 163, 167 (Bankr. N.D. Ga. 1981) (refusing to include a guaranty as an indebtedness absent showing that obligor had failed to pay it).

87 The literature dealing with the interrelationship of guaranties, fraudulent transfers and voidable preferences, particularly under the Code, is extensive. See, e.g., Carl, supra note 53; Pitts, Insider Guaranties and the Law of Preferences, 55 Am. Bankr. L.J. 343 (1981); Walls, supra note 75; Note, Section 548(a)(2), supra note 14.

88 An "actual intent to hinder, delay, or defraud" may constitute a fraudulent transfer without regard to the financial condition of the debtor. U.F.T.A. § 4(a)(1), 7A U.L.A. 652 (1985). This Article excludes such cases from consideration.

The issuance of a downstream guaranty by a parent corporation does not present the same problem in view of the proprietary interest of the parent in the subsidiary. The additional liability incurred by the parent is offset by a comparable increase in the value of its equity interest. Therefore, the downstream guaranty is similar to a capital contribution to the subsidiary. Accordingly, downstream guaranties may generally be ignored in this context. Where, however, the subsidiary is insolvent, the parent may no longer possess any equity interest to enhance.

payment by an affiliate, either of the obligation of an affiliated debtor-obligor or of its own obligation guaranteed by an affiliated debtor-guarantor, that constitutes a fraudulent transfer to the affiliate debtor also constitutes a transfer that is recoverable from the creditor.

Thus, a review of the UFTA's impact on guaranties must also include an inquiry into the provisions of the statute that deal solely with transfers, excluding obligations or guaranties, in order to deal with transfers in payment of guaranteed indebtedness that may represent a fraudulent transfer to the guarantor. One such provision is section 5(b).[89]

1. Section 5(b) and Related Provisions

One of the UFTA's most noteworthy changes is section 5(b), which deals with insider preferential transfers.[90] In the same way that section 547(b)(4) of the Code, dealing with insider voidable preferences, supplements the fraudulent transfer provisions of section 548, section 5(b) supplements the provisions of UFTA section 4(b). It renders a transfer fraudulent as to present creditors when the transfer was "made to an insider for an antecedent debt, [and] the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent."[91] The transfer is voidable even where the antecedent debt represents "reasonably equivalent value."[92]

Following sections 101(2), 25(B) and 25(E) of the Code,[93] UFTA sections 1(7)(ii)(C) and 1(7)(iv) broadly define "insider" to include "a person in control," an "affiliate," and an "insider" of an "affiliate."[94] Section 1(1) defines "affiliate" equally broadly to include any person entitled by ownership or control or power to vote twenty percent or more of voting stock.[95] The comprehensive definitions of "insider" and "affiliate" clearly include every constituent company of a corporate group—parent, subsidiaries, and sister subsidiaries—and thus lay the groundwork for the application of the UFTA to upstream, cross-stream, and downstream guaranties and transactions.[96]

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[89] U.F.T.A. § 5(a), 7A U.L.A. 657 (1985).

[90] Id. § 5(b).

[91] U.F.T.A. § 5(b), 7A U.L.A. 657 (1985).

[92] See Alces & Dorr, supra note 54, at 544. If the transferee provides adequate new value, UFTA § 8(f)(1) provides that § 5(b) is inapplicable. See U.F.T.A. § 8(f)(1), 7A U.L.A. 662-63 (1985).

[93] 11 U.S.C. §§ 101(2), (25)(B), (25)(E), (28)(B), (28)(E) (1982 & Supp. III 1985).

[94] U.F.T.A. §§ 1(7)(ii)(C), 1(7)(iv), 7A U.L.A. 644-45 (1985).

[95] Id. § 1(1), 7A U.L.A. 643 (1985).

[96] See id. § 1(1)(ii); see also 11 U.S.C. § 101(2) (1982 & Supp. III 1985) (definition of affiliate).

2. Restrictions of Section 5(b) to Transfers, Excluding Guaranties

UFTA section 5(b) refers only to a "transfer." This section contrasts vividly with its companion sections relating to fraudulent transactions, i.e., sections 4(a) and 5(a), which more broadly refer to "[a] transfer made *or obligation incurred*."[97] With the issuance of a guaranty, the guarantor incurs an obligation,[98] but no transfer takes place. A transfer takes place only when the guarantor or some other party makes a payment in reduction of the indebtedness that has been guaranteed.[99] Thus, it is clear that the issuance of a guaranty is not included in section 5(b) although payments pursuant to the guaranty are, of course, included.[100]

Although section 5(b) does not include the issuance of a guaranty by a debtor, UFTA section 4 includes "obligations" and, therefore, the issuance of guaranties.[101] Section 4(a)(1) applies if the debtor "incurred the obligation: (1) with actual intent to hinder, delay, or defraud any creditor."[102] Section 4(a)(2) applies if

> the debtor . . . incurred the obligation:
>
> . . . .
>
> (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> (ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her]

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97 U.F.T.A. §§ 4(a), 5(a), 7A U.L.A. 652-53, 657 (1985) (emphasis added).

98 Although contingent liabilities, guaranties have been held to constitute "obligations incurred" under the UFCA. See, e.g., United States v. Gleneagles Inv. Co., 565 F. Supp. 556, 576 (M.D. Pa. 1983) (although not borrowers, guarantors nevertheless incur an obligation), modified on other grounds sub. nom. United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986), cert. denied, 107 S. Ct. 3229 (1987); Zellerbach Paper Co. v. Valley Nat'l Bank, 13 Ariz. App. 431, 433-34, 477 P.2d 550, 552-53 (1970) ("a person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured"); Roxbury State Bank v. The Clarendon, 129 N.J. Super. 358, 376-77, 324 A.2d 24, 33 ("A guaranty is an agreement to be answerable personally for the debt of another."), cert. denied, 66 N.J. 316, 331 A.2d 16 (1974).

99 Transfer is defined to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." U.F.T.A. § 1(12), 7A U.L.A. 645 (1985).

100 The Official Comment and the Reporter's Note to the UFTA do not discuss the reason for the omission, but the explanation is obvious in light of the origin of § 5(b), which is discussed supra notes 166-84 and accompanying text. See Kennedy, supra note 54.

101 U.F.T.A. § 4, 7A U.L.A. 652 (1985).

102 Id. § 4(a)(1).

ability to pay as they became due.[103]

Section 4 makes such transfers or the incurring of such obligations fraudulent as to both present and future creditors.[104]

Section 5(b) differs from section 4(a)(2) in that it extends protection only to present creditors and utilizes the test of whether the debtor was or became insolvent.[105] As emphasized by the Second Circuit in *Rubin v. Manufacturers Hanover Trust Co.*,[106] in the closely analogous area of the Bankruptcy Act, the statutory test for solvency related solely to the financial position of the debtor.[107] While the solvency of the debtor's affiliates or the group as a whole may be helpful in ascertaining the financial soundness of the debtor, the question for determination is the solvency of the debtor, not of the enterprise of which it may be a part.[108]

As noted, UFTA section 2(a) employs the bankruptcy definition of insolvency.[109] However, in a departure from both the UFCA and the Code, UFTA section 2(b) also includes the equity definition of insolvency, providing that "[a] debtor who is generally not paying his [or her] debts as they become due is presumed to be insolvent."[110] Thus, the omission of guaranties from section 5(b) is significant only in the case of the issuance of a guaranty by a corporation that is insolvent under the statutory bankruptcy standard but which does not fall within section 4(a)(2), either as a debtor with "unreasonably small . . . remaining assets" or as a debtor that satisfies the statutory test with respect to incurring debts beyond his (or her) ability to pay as they become due. Although there will, no doubt, be such companies, there should not be many, because a corporation whose liabilities exceed its assets will usually not be able to escape both the "unreasonably small . . . remaining assets" test and the equity-insolvency test. The omission of guaranties from section 5(b), although undesirable, should not be regarded as creating any serious gap in the statutory scheme.

3. The Origins of Section 5(b)

The origins of section 5(b) are reasonably clear. Section 5(b) is

103 Id. § 4(a)(2), 7A U.L.A. 652-53 (1985).

104 Id. § 4, 7A U.L.A. 652 (1985).

105 See id. § 5(b), 7A U.L.A. 657 (1985).

106 661 F.2d 979 (2d Cir. 1981).

107 Id. at 995.

108 Id.

109 The Code provides that an "entity" is "insolvent" when the sum of its "debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. § 101(29)(A) (Supp. III 1985).

110 U.F.T.A. § 2(b), 7A U.L.A. 648 (1985).

derived from section 547(b)(4) of the Code which provides that certain insider transfers constitute voidable preferences.[111] Section 547(b)(4) also omits any reference to obligations (or to guaranties). It was inserted to fill the gap created by the change in the fraudulent transfer provisions of section 548 of the Code from the fraudulent transfer provisions of the Bankruptcy Act.[112]

Section 548(a)(2)(A) of the Code employs "reasonably equivalent value" as the standard for the adequacy of consideration in determining whether certain transfers are fraudulent.[113] It replaces "fair consideration," the standard used in section 67d(2)(a) of the Bankruptcy Act,[114] and in UFCA sections 3 and 4.[115]

"Good faith" was an essential component of "fair consideration," and numerous cases under the Bankruptcy Act and the UFCA held that transfers for the benefit of insiders were fraudulent for lack of good faith even though the consideration was otherwise adequate.[116] The substitution of "reasonably equivalent value" for "fair consideration" and the resulting elimination of the "good faith" requirement accordingly created a gap in the statutory scheme. To deal with this problem, section 547(b) of the Code provides that certain transfers to an insider "for or on account of an antecedent debt" are voidable preferences even though they may not be fraudulent transfers as, for example, where the antecedent debt constituted "reasonably equivalent value."[117]

The structure of the UFTA is much the same. UFTA section 4(a) followed section 548(a)(2)(A) of the Code in adopting the "reasonably equivalent value" standard for fraudulent transfers in place of the "fair consideration" standard used by sections 3 and 4 of the UFCA and section 67d(2)(a) of the Bankruptcy Act. The drafters therefore faced the same problem with respect to the elimination of

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111 11 U.S.C. § 547(b)(4) (1982 & Supp. III 1985).

112 See Kennedy, supra note 54, at 204-05.

113 11 U.S.C. § 548 (1982 & Supp. III 1985).

114 11 U.S.C. § 107d(2) (1976) (repealed).

115 U.F.C.A. §§ 3-4, 7A U.L.A. 448, 474 (1985).

116 E.g., Midland Supply Co. v. American Drilling Co., 302 F.2d 128 (10th Cir. 1962); Cohen v. Sutherland, 257 F.2d 737, 742 (2d Cir. 1958); Epstein v. Goldstein, 107 F.2d 755, 757 (2d Cir. 1939); United States v. Gleneagles Inv. Co., 565 F. Supp. 556, 574 (M.D. Pa. 1983), modified on other grounds sub nom. United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986), cert. denied, 107 S. Ct. 3229 (1987); Seligson v. New York Produce Exch., 378 F. Supp. 1076 (S.D.N.Y. 1974); *In re* Messenger, 32 F. Supp. 490, 494 (E.D. Pa. 1940); Bergquist v. First Nat'l Bank (*In re* American Lumber Co.), 5 Bankr. 470 (D. Minn. 1980). See Levin, An Introduction to the Trustee's Avoiding Powers, 53 Am. Bankr. L.J. 173, 180-81 (1979); Normandin, supra note 3, at 375-77; Note, Good Faith and Fraudulent Conveyances, 97 Harv. L. Rev. 495, 503-09 (1983).

117 11 U.S.C. § 547(b) (1982 & Supp. III 1985).

the "good faith" element that had arisen in the Code. As recognized by the reporter,[118] if a section like 5(b) had not been inserted, insider preferential transfers would have been invulnerable in light of the changes in section 4.[119]

Section 5(b) was modelled after section 547(b)(4) of the Code using comparable language in an attempt to protect the debtor's estate against depletion. However, since it is a part of a statute dealing with fraudulent transfers, it treats such transfers for the benefit of insiders as fraudulent transfers, whereas section 547(b)(4) of the Code treats them as voidable preferences.

Section 547 refers only to transfers and does not refer to the incurring of obligations or guaranties for the benefit of insiders. Section 547 of the Code deals with voidable preferences. Since a preference can only arise as a result of a payment or other transfer in reduction of an antecedent debt, the innovative provisions of section 547 relating to actions for the benefit of insiders inevitably referred only to transfers. This structural problem does not arise under UFTA section 5(b), which deals with fraudulent transfers not preferences, and could have included obligations and guaranties just as its predecessor enactment, UFCA section 4, had done. However, it failed to do so. It is not evident why this omission occurred. One possible explanation is the not unnatural desire of the draftsmen to have the UFTA correspond to the Code's provisions as much as possible. Another is the fact that section 5(b) was adopted very late in the process. As late as November 1983, the UFTA draft contained no provision derived in any way from section 547(b)(4). Section 5(b) was apparently added in the final preparation of the definitive draft for submission to the National Conference of Commissioners on Uniform State Laws, where it was approved on August 3, 1984.[120] Accordingly, section 5(b) ap-

118 See Kennedy, supra note 54, at 204.

119 The problem arose as a result of the adoption of the "reasonably equivalent value" standard in the Code, 11 U.S.C. § 548 (1982) and U.F.T.A. § 4(a)(2), 7A U.L.A. 652-53 (1985) in place of the "fair consideration" standard previously used in the Bankruptcy Act, 11 U.S.C. § 67d (1976) (repealed 1978), and U.F.C.A. § 4, 7A U.L.A. 474 (1985). In the absence of § 547(b)(4) of the Code and UFTA § 5(b), a transfer by an insolvent to an insider in payment of an antecedent debt would no longer have been voidable because such transfers had previously been voidable only because they had not satisfied the "good faith" test implicit in the "fair consideration" standard. See supra note 116 and accompanying text.

120 The draft of § 5(b) was restricted to a limited class of insider transfers: a transfer of substantially all of a debtor's assets to a lienor in satisfaction of a lien, and the lienor's retransfer to an insider of the debtor. U.F.T.A. § 5(b) (Nov. 23, 1983 draft).

Section 3 of the November 23, 1983 draft also contained an innovative provision that would have strengthened the status of intragroup guaranties. It provided that: "An obligation to pay the debt of another who has received value in exchange for the debt is incurred for an equivalent value if there is a *community of interest* between the obligor and the beneficiary of

pears to be a belated recognition that some provision of general application was necessary in order to deal with the insider preferential transfer problem.

4. Defenses to Insider Transfers

UFTA section 8(f) creates certain defenses and limitations of liability, excluding from the provisions of section 5(b) certain insider transfers that would otherwise fall under its provisions. It provides, in pertinent part, as follows:

> A transfer is not voidable under Section 5(b):
>
> (1) to the extent the insider gave new value . . . unless the new value was secured by a valid lien;
>
> (2) if made in the ordinary course of business or financial affairs of the debtor and the insider; or
>
> (3) if made pursuant to a good-faith effort to rehabilitate the debtor and the transfer secured present value given for that purpose as well as an antecedent debt of the debtor.[121]

Sections 8(f)(1) and 8(f)(2)[122] are derived from sections 547(c)(4)(A) and 547(c)(2)(C) of the Code,[123] respectively. Section 8(f)(3),[124] however, is a notable change that commendably breaks new statutory ground. As noted in the official comment, section 8(f)(3) "reflects a policy judgment that an insider who has previously extended credit to a debtor should not be deterred from extending further credit to the debtor in a good faith effort to save the debtor from a forced liquidation in bankruptcy or otherwise."[125] Since it is useful to encourage continued financial support on the part of insiders of enterprises undergoing financial difficulties in order to increase the struggling firm's chances for survival, a statutory standard that rendered such support vulnerable to avoidance as a fraudulent transfer was manifestly counterproductive.

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the obligation." U.F.T.A. § 3 (Nov. 23, 1983 draft) (emphasis added). It was recognized that this draft provision was not entirely satisfactory. See Letter from Frank R. Kennedy, Reporter, to the Members of the Drafting Committee for the Uniform Fraudulent Transfer Act (Aug. 18, 1983) at 13 ("This addition, no doubt, raises new questions and certainly does not resolve all the old questions that surround this subsection."). The provision was omitted in the definitive draft.

121 U.F.T.A. § 8(f), 7A U.L.A. 662-63 (1985).

122 Id. §§ 8(f)(1)-(2), 7A U.L.A. 663 (1985).

123 11 U.S.C. § 547(c)(2)(C), (4)(A) (1982 & Supp. III 1985).

124 U.F.T.A. § 8(f)(3), 7A U.L.A. 663 (1985).

125 Id. § 8 comment 6, 7A U.L.A. 665 (1985).

5. Other Differences between Section 5(b) and Section 547(b)(4) of the Code

Although UFTA section 5(b) is generally derived from section 547(b)(4) of the Code, substantially duplicating the Code's more important provisions, there are a number of significant differences, including:

(a) different standards for establishing "insolvency;"

(b) different requirements with respect to the insider's "reasonable cause to believe" the debtor was insolvent;

(c) the omission of any reference to indirect transfers;

(d) a slightly different limitation period for the institution of actions; and

(e) the existence of judicial gloss with respect to voidable preferences restricting the enforcement of section 547(b)(4) and the absence of any such judicial standard in the enforcement of section 5(b).

a. *Different Standards for Establishing Insolvency*

UFTA section 5(b) and section 547(b) of the Code both require that the debtor be insolvent at the time of the transfer for the transfer to be deemed fraudulent. The statutes differ, however, with respect to proof of insolvency. Section 547(f) of the Code presumes insolvency in the case of transfers during the ninety-day period prior to the filing of the bankruptcy petition and imposes the burden of proof on the trustee in the case of transfers occurring more than ninety days but less than one year prior to the filing.[126] The UFTA requires the trustee to prove insolvency in all cases. However, in a novel provision that has no counterpart in either the Code[127] or the Bankruptcy Act, UFTA section 2(b) provides: "A debtor who is generally not paying his [or her] debts as they become due is presumed to be insolvent."[128] This presumption is rebuttable. It was inserted "in recognition of the difficulties typically imposed on a creditor in proving insolvency in the bankruptcy sense."[129] Thus, the evidentiary burdens in establishing a debtor's failure generally to pay debts as they become due and payable in many cases is substantially less demanding than the valua-

126 11 U.S.C. § 547(f) (1982). See 4 Collier on Bankruptcy ¶ 547.28, at 547-109 (L. King 15th ed. 1987).

127 In one section, the Code provides that in the case of an *involuntary* petition, the court shall order relief only if "(1) the debtor is generally not paying such debtor's debts as such debts become due. . . ." See 11 U.S.C. § 303(h)(1) (Supp. III 1985). This equity standard of bankruptcy, however, is not employed elsewhere in the Code.

128 U.F.T.A. § 2(b), 7A U.L.A. 648 (1985).

129 Id. § 2 comment (2), 7A U.L.A 648-49 (1985).

tion of assets required for implementation of the bankruptcy standard of insolvency.

b. *Insider's "Reasonable Cause to Believe"*

Section 5(b) requires not only that the debtor be insolvent but that the insider have "reasonable cause to believe that the debtor was insolvent."[130] This provision is much the same as the original section 547(b)(4) of the Code, which required that the insider have "reasonable cause to believe" in the case of transfers occurring more than ninety days but less than one year prior to the filing of the bankruptcy petition.[131] There was no such requirement, however, either for creditors generally or for insiders in the case of transfers made within ninety days of the petition.[132] However, in 1984 the Code was amended and the "reasonable cause" provision was deleted. Since the 1984 amendment, section 547(b) has contained no such provision. The Bankruptcy Amendments and Federal Judgeship Act of 1984,[133] accomplishing this change, became law on July 10, 1984. The National Conference of Commissioners on Uniform State Laws approved the UFTA on August 3, 1984.[134] There obviously had not been enough time to respond to the change in the Code, even if the draftsmen had been so minded. As a result, this unfortunate difference between the Code and UFTA exists.

The inclusion of a provision in the UFTA with respect to "reasonable cause to believe" has been criticized as unrealistic on the well-grounded assertion that insiders will inevitably be well informed of the debtor's condition.[135] By the same token, however, the amendment should make little difference in the typical case. In the corporate group, it would be a most unusual case in which corporate management could successfully assert that it lacked information about the financial condition of the component companies of the group.[136] Although the difference between the Code and the UFTA is undesirable as a matter of principle, it does not seem particularly important. Further, in view of the wide attribution rules for determining

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130 Id. § 5(b), 7A U.L.A. 657 (1985).

131 Pub. L. No. 95-598, § 547(b)(4), 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. § 547(b)(4) (1982 & Supp III 1985)).

132 This provision in the Code was derived from section 60b of the Bankruptcy Act which required that "reasonable cause to believe" be shown in all cases. 11 U.S.C. § 60b (1976) (repealed 1978).

133 Pub. L. No. 98-353, § 462(b)(2), 98 Stat. 333 (1984).

134 See Kennedy, supra note 54, at 195.

135 See Alces & Dorr, supra note 54, at 553.

136 See P. Blumberg, Corporate Groups: Bankruptcy, supra note 6, § 9.11, at 389.

insiders,[137] the provisions of section 5(b) may serve some useful purposes in isolated cases affecting individuals within family corporations.[138]

c. *Omission of Reference to Indirect Transfers*

There is a puzzling departure in the language of UFTA section 5(b) from the comparable language in section 547(b) of the Code. Section 5(b) refers only to "transfers made to an insider,"[139] and thus pointedly departs from the more inclusive standard in section 547(b) which refers to "any transfer . . . (1) to *or for the benefit of* a creditor . . . (4) made . . . (B) . . . if such creditor . . . (i) was an insider."[140] Section 60b of the Bankruptcy Act had similarly referred to "a transfer . . . to or for the benefit of a creditor."[141] What is the significance of the omission of the critical reference to "or for the benefit of a[n insider] creditor?"[142]

d. *Period of Limitation*

UFTA section 9(c) adopts a special one-year limitation period for instituting actions with respect to transfers allegedly fraudulent under section 5(b).[143] This limitation period can be contrasted with the four-year period established by the UFTA for fraudulent transfers generally.[144] On initial inquiry, the one-year period in section 9(c) appears to correspond to the one-year period in section 547(b)(4)(B) of the Code during which preferential transfers to insiders are avoidable. However, the UFTA one-year period in some cases may be distinctly more liberal than the one-year period under the Code. The period under the Code is absolutely fixed by the dates of the transfer and the filing of the petition. The commencement of the UFTA one-year period, however, like all periods of limitation, may be tolled under appropriate circumstances. It should be noted that section 9(a)

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137 In the case of corporations, U.F.T.A. § 1(7)(ii), 7A U.L.A. 644 (1985) includes as an "insider," a director, an officer, a "person in control," a related partnership and its general partners, or "a relative of a general partner, director, officer or person in control of the debtor."

138 See, e.g., Consove v. Cohen (*In re* Roco Corp.), 15 Bankr. 813 (Bankr. D.R.I. 1981), aff'd in part, vacated in part, 21 Bankr. 429 (Bankr. 1st Cir. 1982), aff'd, 701 F.2d 978 (1st Cir. 1983) (father in retirement in Florida held not to have "reasonable cause to believe" insolvency of family corporation managed by son in New York).

139 U.F.T.A. § 5(b), 7A U.L.A. 657 (1985).

140 11 U.S.C. § 547(b) (1982 & Supp. III 1985) (emphasis added).

141 11 U.S.C. § 60b (1976) (repealed 1978).

142 This problem of construction is discussed infra notes 147-64 and accompanying text (addressing transfers in payment of guaranteed indebtedness).

143 U.F.T.A. § 9(c), 7A U.L.A. 665 (1985).

144 Id. §§ 9(a), (b).

provides a special tolling provision with respect to transfers under section 4(a)(1) dealing with transfers with "actual intent to hinder, delay, or defraud." This provision is not contained in section 9(b) dealing with transfers under section 4(a)(2) nor in section 9(c) dealing with transfers under section 5(b). The official comment sheds no light on the significance of the omission of any special tolling provision in sections 9(b) and (c). Thus, whether the drafters intended—by the reference in section 9(a)—to exclude tolling of the limitation period in the latter sections according to traditional judicial standards is an open question. If the statute is so construed to permit such tolling, there will be cases in which the UFTA period will be extended beyond one year and thus depart from the fixed one-year period in the Code.

e. *Differing Application of Judicial Gloss on Voidable Preferences*

In still another area the UFTA may differ from the Code. Section 547(b) of the Code treats an insider preferential transfer as a *voidable preference*, not as a fraudulent transfer. This characterization of an insider preferential transfer brings into play certain judicial doctrines limiting the application of statutory provisions applicable to voidable preferences that have no application to fraudulent transfers. Thus, under the judicial gloss, notwithstanding the statutory provision, a preference is not voidable unless the transfer violates the policy of "equality among creditors" and enables the creditor to receive more than he would otherwise be entitled.[145] The UFTA, treats insider preferential transfers as fraudulent transfers rather than as voidable preferences and has no comparable limiting judicial doctrine to bring about the same result.

6. Application of Section 5(b) to Transfers Involving Insiders and Guaranteed Indebtedness

Transfers involving insiders and guaranteed indebtedness may involve debtors in a number of ways: (a) a debtor-obligor may pay antecedent indebtedness guaranteed by an insider;[146] (b) a debtor-guarantor may pay antecedent indebtedness of an insider; (c) an insider-guarantor may pay antecedent indebtedness of the debtor; or (d) an insider-obligor may pay its own antecedent indebtedness guaranteed by the debtor. A question arises as to when such transactions constitute insider preferential transfers subject to avoidance under section 5(b).

[145] 11 U.S.C. § 547(b)(5) (1982). See Nimmer, Security Interests in Bankruptcy: An Overview of Section 547 of the Code, 17 Hous. L. Rev. 289, 292 (1980).

[146] This situation occurs most often.

A further question relates to the position of a third-party creditor who holds the antecedent indebtedness that is the subject of the foregoing transfers. If the transfer is subject to avoidance as a voidable preferential transfer to an insider, what is the position of the creditor? These questions are reviewed in the succeeding sections.

a. *Transfers by a Debtor-Obligor in Payment of Debt Guaranteed by an Insider*

Does a transfer by a debtor-obligor in payment of an antecedent debt guaranteed by an insider represent a fraudulent transfer to the insider? Under the UFCA and the Bankruptcy Act, such transfers benefiting the insider-guarantor by reduction of the indebtedness on which it was secondarily liable could not satisfy the "good faith" factor in "fair consideration." Accordingly, they were routinely held to constitute fraudulent transfers under UFCA sections 3 and 4 and section 67d(2)(a) of the Bankruptcy Act.[147]

As noted, under the UFTA, "fair consideration" has been eliminated with the substitution of "reasonably equivalent value," and "good faith" is no longer a factor. The fraudulent transfer provisions of section 4(a)(2) which employ the "reasonably equivalent value" standard do not include such transfers where the satisfaction of an antecedent debt represents "reasonably equivalent value." No depletion of the estate has occurred.

Section 5(b), we have seen, was added to deal with the resulting gap in the statute lest "preferential transfers to insiders [became] invulnerable to avoidance"[148] in much the same way that section 547(b) making such transfers voidable preferences was inserted in the Code to deal with the similar gap resulting from the substitution of "reasonably equivalent value" for "fair consideration" in the enactment of section 548. Under section 547(b) such payments are voidable preferences.[149] A guarantor is a creditor for purposes of the Code,[150] and a payment by a debtor that reduces the liability of the guarantor constitutes a preference.[151] Does section 5(b) apply where the debtor makes

[147] See supra notes 115 and 119.

[148] See U.F.T.A. § 5 comment 2, 7A U.L.A. 639, 658 (1985); Kennedy, supra note 54, at 205.

[149] See supra text accompanying note 145.

[150] 11 U.S.C. § 101(9) (1982 & Supp. III 1985). See Keystone Automotive Warehouse Inc. v. LaBonte (*In re* LaBonte), 13 Bankr. 887, 891 (Bankr. D. Kan. 1981); Notes of Comm. on Judiciary, S. Rep. No. 989, 95th Cong., 2d Sess. 22 (1978) ("A guarantor of... a claim against the debtor is also a creditor, because he holds a contingent claim against the debtor that becomes fixed when he pays the creditor whose claim he has guaranteed.").

[151] Kapela v. Newman, 649 F.2d 887, 890 n.3 (1st Cir. 1981); Pennington v. Leff, 183 F. Supp. 884 (S.D. Ala. 1960); Armstrong v. Marine Bank Dane County (*In re* Prescott), 51

a transfer in payment of the guaranteed obligation to a creditor who is a third party, and not an insider, but which benefits the insider through the reduction of the indebtedness on which the insider-guarantor is secondarily liable?

Section 5(b) does not refer to such third-party transfers. It speaks only of a "transfer . . . made to an insider for an antecedent debt."[152] In contrast, section 547(b), which otherwise served as the model for section 5(b),[153] expressly refers to "any transfer . . . (1) to or for the benefit of a[n insider] creditor."[154] In the face of this significant omission, the following question arises: Does section 5(b) include transfers to third parties of antecedent debt guaranteed by an insider?

At first, it would seem difficult to conclude that the draftsmen of the UFTA who were faithfully following the very structure and language of section 547(b) of the Code in drafting UFTA section 5(b) were simply inadvertent in their omission of the crucial phrase "or for the benefit of," especially since it appears that they were otherwise tracking the language of section 547(b). Traditional rules of statutory construction would conclude that as a result of the omission of the phrase, the manifest intent was to exclude transfers to third parties. Nevertheless, however appealing such a construction might seem in the ordinary case, it does not seem sound in the instant case for a number of reasons.

First, such a substantive change would be major. Yet, there is not a syllable of reference to such an intention in the comprehensive and informative official comment. Nor does the reporter refer to any such substantive change in his careful review of the newly adopted

Bankr. 751 (Bankr. W.D. Wis. 1985), aff'd, 805 F.2d 719 (7th Cir. 1986) (reversing part of unpublished district court opinion and reinstating bankruptcy court's decision); Levit v. Melrose Park Nat'l Bank (*In re* V.N. Deprizio Constr. Co.), 58 Bankr. 478 (Bankr. N.D. Ill. 1986); Mixon v. Anderson (*In re* Ozark Restaurant Equip. Co.), 41 Bankr. 476 (Bankr. W.D. Ark. 1984), aff'd in part, rev'd in part, 61 Bankr. 750 (W.D. Ark. 1986), aff'd, 816 F.2d 1222 (8th Cir. 1987); Mixon v. Mid-Continent Sys., Inc. (*In Re* Big Three Transp., Inc.), 41 Bankr. 16 (Bankr. W.D. Ark. 1984); McColley v. Matmom Gem Co. (*In re* Candor Diamond Corp.), 44 Bankr. 195 (Bankr. S.D.N.Y. 1984); Marketing Resources Int'l Corp. v PTC Corp. (*In re* Marketing Resources Int'l Corp.), 41 Bankr. 575 (Bankr. E.D. Pa. 1984); Schmitt v. Equibank (*In re* R.A. Beck Builders, Inc.), 34 Bankr. 888, 892 (Bankr. W.D. Pa. 1983); Backhus v. Cent. Trust Co. (*In re* Duccilli Formal Wear, Inc.), 24 Bankr. 699, 700 (Bankr. S.D. Ohio 1982). See H.R. Rep. No. 595, 95th Cong., 1st Sess. 309-10 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6266-67; 4 Collier on Bankruptcy ¶ 547.04, at 547-30 (L. King 15th ed. 1987).

152 U.F.T.A. § 5(b), 7A U.L.A. 657 (1985).

153 See supra notes 111-20 and accompanying text.

154 11 U.S.C. § 547(b)(1) (1982).

UFTA.[155] If such a change had been intended, it is most unlikely that it would have been made without some explanation.

Second, such a change would have been inconsistent with the evident policy underlying section 5(b). Section 5(b) was intended to proscribe transfers that had been previously rendered fraudulent by the "good faith" standard of "fair consideration" and to supplement the "reasonably equivalent value" standard of section 4(a)(2) in the same way that the comparable provisions of section 547 of the Code from which section 5(b) were derived to supplement the "reasonably equivalent value" standard of section 548 of the Code. Section 547(b) of the Code follows section 60b of the Bankruptcy Act and includes "transfer[s] to or for the benefit of a[n insider] creditor."[156] If the reference in UFTA section 5(b) to a "transfer . . . made to an insider" is not construed to include such indirect transfers, a provision inserted to bring the UFTA into harmony with the Code and to prevent the creation of a "vulnerable" gap for preferential insider transfers[157] would instead leave a serious loophole of the very type that it was intended to prevent.

Third, UFTA section 8(b)(1) provides that in the case of a transfer voidable under the Act, "the creditor may recover judgment for the value of the asset transferred . . . against: (1) the first transferee of the asset *or the person for whose benefit the transfer was made*."[158] Section 8(f)(1) similarly provides that "[a] transfer is not voidable under Section 5(b): (1) to the extent the insider gave new value to *or for the benefit of the debtor* after the transfer was made."[159] Such references would indicate that the draftsmen of the UFTA intended to include indirect as well as direct transfers within the scope of section 5(b).

Fourth, construction of "transfer" to mean indirect, as well as direct, insider preferential transfers is a normal process in construing statutes to implement their underlying policy. This process is aptly illustrated by the law with respect to the converse cases of whether a debtor may receive "fair consideration" or "reasonably equivalent value" by reason of a transfer to a related third party. Notwithstanding the lack of any statutory reference to indirect transfers in this connection, numerous cases have held that where a benefit to the debtor can be demonstrated, it will suffice for this purpose even

155 See Kennedy, supra note 54.
156 11 U.S.C. § 547(b)(1) (1982).
157 See Kennedy, supra note 54, at 204-05.
158 U.F.T.A. § 8(b)(1), 7A U.L.A. 662 (1985) (emphasis added).
159 Id. § 8(f)(1), 7A U.L.A. 662-63 (emphasis added).

though it may be indirect.[160] The difficulty, however, is not so much the language employed, but whether the omission of the reference to "for the benefit of" demonstrates a contrary statutory policy. Although the omission creates some inference that indirect transfers are not included, such an inference seems much less persuasive than the considerations reviewed above, which strongly suggest that the draftsmen could not have intended the exclusion of indirect transfers.

Finally, as previously noted, section 5(b) was adopted late in the drafting process.[161] This belated insertion of the section makes the inference even more plausible that the omission was an inadvertent error in the last stages of preparation and that it was not intended to exclude indirect transfers from the sweep of a provision intended to close the door to insider preferential transfers generally. Thus, all things considered, it would appear that section 5(b) should be read to include indirect preferential insider transfers and thereby conform to section 547(b) of the Code. A contrary construction would create a deplorable gap in the statute that would call for immediate rectification.

Above and beyond the issue of the application of section 5(b), there is a possible alternative route for striking down such indirect transfers as fraudulent under the UFTA. Section 4(a)(1), the roots of which go back to the Statute of 13 Elizabeth I[162] is applicable to any transfer "with actual intent to hinder, delay, or defraud any creditor" without reference to "reasonably equivalent value."[163] While, this provision could be invoked to deal with cases of indirect preferential insider transactions, it is obviously not a desirable route. In addition to the necessity of ploughing new ground, such an attack would also have to run the hurdle of proving "actual intent" in order to render fraudulent a transaction that had been constructively fraudulent under prior law. It would remain available, however, as a last resort.

In the event that section 5(b) is construed to include transfers "for the benefit" of an insider, it clearly covers transfers by a debtor in payment of antecedent indebtedness guaranteed by an insider, that is, upstream, cross-stream, and downstream guaranties. Numerous cases under section 547(b)(4) have so held.[164]

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160 See id. § 6 comment 3, 7A U.L.A. 660; P. Blumberg, Corporate Groups: Bankruptcy, supra note 6, § 8.04 to .07, at 347-53; Walls, supra note 75, at 222.

161 See supra note 120 and accompanying text.

162 Statute of 13 Eliz. I, ch. 5 (1570).

163 U.F.T.A. § 4(a)(1), 7A U.L.A. 653 (1985).

164 E.g., Mixon v. Anderson (*In re* Ozark Restaurant Equip. Co.), 41 Bankr. 476 (Bankr. W.D. Ark. 1984), aff'd in part, rev'd in part, 61 Bankr. 750 (W.D. Ark. 1986), aff'd, 816 F.2d 1222 (8th Cir. 1987); Levit v. Melrose Park Nat'l Bank (*In re* V.N. Deprizio Constr. Co.), 58

b. *Transfer by a Debtor-Guarantor in Satisfaction of an Insider's Debt*

Unlike the foregoing problem of the debtor-obligor and insider-guarantor, which is relatively common, the converse problem of the debtor-guarantor and the insider-obligor has not been the subject of much judicial inquiry. It involves a transfer by a debtor-guarantor in payment of an antecedent debt on which it is secondarily liable that benefits an insider-obligor. While the transfer has been to the creditor for the benefit of the insider, not to the insider, the debtor's estate has been depleted for the benefit of the insider, and creditors have been prejudiced. Accordingly, the transfer should be voidable as it was under the UFCA and the Bankruptcy Act, and as it is under the Code. Although the debtor is subrogated to the creditor's rights against the insider, avoidance of the transfer will almost invariably be a much more appealing remedy than pursuing a claim against the insider.

c. *Transfer by an Insider-Guarantor in Satisfaction of Debt of the Debtor-Obligor*

Where a guarantor makes a transfer to reduce the indebtedness of the debtor, there has been no transfer by the debtor. The guarantor will be subrogated to the rights of the creditor against the debtor. This change in the identity of the creditor results in no change in the debtor's assets or liabilities, nor any depletion of its estate. Accordingly, the issue of a fraudulent transfer (or of a voidable preference under the Code) does not normally arise when a guarantor satisfies a debtor-obligor's indebtedness that it has guaranteed. Where, however, the guarantor and the debtor are controlled corporation and controlling shareholder, or under common control, as in the case of affiliated corporations of a corporate group, the problem is more complex.

In the case of intragroup guaranties and transactions, the ques-

Bankr. 478 (Bankr. N.D. Ill. 1986); Bergquist v. Anderson-Greenwood Aviation Corp. (*In re* Bellanca Aircraft Corp.), 56 Bankr. 339 (Bankr. D. Minn. 1985); Beemer v. Crandon Enters. (*In re* Holly Hill Medical Center), 53 Bankr. 412 (Bankr. M.D. Fla. 1985); Marketing Resources Int'l Corp. v. PTC Corp. (*In re* Marketing Resources Int'l Corp.), 41 Bankr. 575 (Bankr. E.D. Pa. 1984); Mixon v. Mid-Continent Sys., Inc. (*In re* Big Three Transp., Inc.), 41 Bankr. 16 (Bankr. W.D. Ark. 1983); McColley v. Matmon Gem Co. (*In re* Candor Diamond Corp.), 44 Bankr. 195 (Bankr. S.D.N.Y. 1984); Backhus v. Central Trust Co. (*In re* Duccilli Formal Wear, Inc.), 24 Bankr. 699 (Bankr. S.D. Ohio 1982); Seeley v. Church Bldgs. & Interiors (*In re* Church Bldgs. & Interiors, Inc.), 14 Bankr. 128 (Bankr. W.D. Okla. 1981). See Goldberger v. Davis Jay Corregated Box Corp. (*In re* Mercon Indus. Inc.), 37 Bankr. 549 (Bankr. E.D. Pa. 1984).

tion arises whether the consequences of a transfer by one affiliate of a corporate group will be attributed to another affiliate so as to render a transaction not literally within the Uniform Acts nevertheless subject to avoidance thereunder. Thus, the Uniform Acts require that the challenged transfer be of "the property of the debtor."[165] When is a transfer by an affiliate deemed a transfer of "the property of the debtor?" Our starting point is the generally accepted proposition that, in light of the statutory reference to "the property of the debtor," a third-party payment of an obligation of an insolvent debtor cannot be attacked as a preference where the payment has been made without the transfer of any "property of the debtor."[166] If the challenge is to be upheld, the debtor's estate must be depleted.[167]

This rule rests on the general principle that a payment by a third party from its own property does not involve either the debtor or the debtor's property. In the case of a corporate group, however, payment by one of its components of the debt of another component, where both are engaged in the conduct of an integrated business or are otherwise closely interrelated, may nevertheless constitute a preferential transfer if the court is prepared to look upon the component companies as collectively comprising a single enterprise. This complex problem necessarily involves a comprehensive review of the numerous cases in allied areas of affiliated corporations (or controlled corporations and controlling shareholders) involving fraudulent transfers and voidable preferences under the UFCA, the Code, and the Bankruptcy Act. Such a review is beyond the scope of this Article.[168] In brief, in the area as a whole, the cases are divided with most courts treating such interrelated parties as separate entities for purposes of the statute.[169] A significant minority, including more recent

165 The UFTA refers to a transfer. U.F.T.A. §§ 4-5, 7A U.L.A. 652-53, 657 (1985). It defines "transfer" as "disposing of or parting with an asset or an interest in an asset," and it defines "asset" as "property of a debtor." Id. §§ 1(2), 1(12), 7A U.L.A. 644, 645. The UFCA is comparable. See U.F.C.A. § 1, 7A U.L.A. 430 (1985).

166 Mason v. National Herkimer County Bank, 172 F. 529 (2d Cir. 1909), aff'd sub nom. National Bank v. National Herkimer County Bank, 225 U.S. 178 (1912); I-T-E Circuit Breaker Co. v. Holzman, 354 F.2d 102 (9th Cir. 1965); Grubb v. General Contract Purchase Corp., 94 F.2d 70 (2d Cir. 1938); *In re* Hines, 144 F. 543 (W.D. Pa. 1906); Dressel v. North State Lumber Co., 119 F. 531 (E.D.N.C. 1902); Marketing Resources Int'l Corp. v. PTC Corp. (*In re* Marketing Resources Int'l Corp.), 41 Bankr. 575 (Bankr. E.D. Pa. 1984).

167 See Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 992 (2d Cir. 1981) (depletion of estate was decisive).

168 See Blumberg, Corporate Groups: Bankruptcy, supra note 6, at 335-98. See also Littman, supra note 1.

169 See, e.g., Markow v. Alcock, 356 F.2d 194 (5th Cir. 1966); I-T-E Circuit Breaker Co. v. Holzman, 354 F.2d 102 (9th Cir. 1965); Galsworthy, Inc. v. Kennedy (*In re* Le Maire Cosmetic Co.), 174 F.2d 749 (7th Cir. 1949); Mandel v. Scanlon, 426 F. Supp. 519 (W.D. Pa. 1977); Ajax Shoe & Leather Co. v. Selig, 305 Mass. 389, 25 N.E.2d 990 (1940); Stone v. Allied

cases, however, support the view that a transfer by an affiliate may be attributed to a debtor.[170]

A number of recent cases shed light on the resolution of the problem in the specific area under review. The decision in *Lawless v. Elmira Milk Producers Cooperative Association (In re Stop-N-Go of Elmira, Inc.)*,[171] decided in 1983 under section 60a of the Bankruptcy Act, involved a subsidiary's issuance of a guaranty of its parent's debt to its supplier, a transaction that rendered the subsidiary insolvent. The court found the subsidiary's subsequent payments in satisfaction of the debt a preference to the supplier and did so in reliance on enterprise principles and without reference to piercing the corporate veil doctrines. The court relied on the creditor's sophistication, its involvement in the "financial woes" of the group, and its knowledge of the parties' close relationship.[172] The shareholder-operators had caused the subsidiary to guarantee the parent's debt to the supplier when the supplier learned that the subsidiary was negotiating for the sale of its twenty-six retail outlets. After the sale, the subsidiary made a $723,915 payment to the supplier under its guaranty. This payment represented the overwhelming bulk of the sales proceeds remaining after payment of the secured creditors. Only $6,000 was left for the subsidiary's unsecured creditors, who held claims of about $1,000,000. The court found that on the facts the supplier was chargeable with knowledge that the transaction rendered the subsidiary insolvent. The companies were part of an economically integrated business and, as the court found, treated by their principals "almost as one company."[173]

Coleman American Moving Services, Inc. v. First National Bank and Trust Co. (In re American Properties, Inc.),[174] decided under the Code, involved a parent corporation's refinancing of an outstanding bank debt of its insolvent subsidiary. The parent arranged a new loan

Clothing Corp., 140 N.J. Eq. 224, 54 A.2d 625 (Ch. 1947); McKay v. Sperry Flour Co., 95 Wash. 209, 163 P. 377 (1917).

170 See, e.g., Cissell v. First Nat'l Bank, 476 F. Supp. 474 (S.D. Ohio 1979); Hillebrand v. Sav-Co., 353 F. Supp. 19 (E.D. Ill. 1972); Lawless v. Eastern Milk Producers Coop. Ass'n (*In re* Stop-N-Go, Inc.), 30 Bankr. 721 (Bankr. W.D.N.Y. 1983); Reese v. Akai Am., Ltd., 19 Bankr. 83 (S.D. Fla. 1982); Coleman Am. Moving Servs., Inc. v. First Nat'l Bank & Trust Co. (*In re* American Properties, Inc.), 14 Bankr. 637 (Bankr. D. Kan. 1981); cf. Regal Ware, Inc. v. Fidelity Corp., 550 F.2d 934 (4th Cir.) (subsidiary's transfer to protect parent against potential liability on its guaranty of subsidiary's debts deemed fraudulent), cert. denied, 434 U.S. 824 (1977).

171 30 Bankr. 721 (Bankr. W.D.N.Y. 1983).

172 The supplier was a milk producer, the parent was a milk processor, and the subsidiary was a major retail outlet. Id. at 722.

173 Id. at 726.

174 14 Bankr. 637 (Bankr. D. Kan. 1981).

from the same bank, secured by a mortgage on assets of a sister subsidiary. The loan proceeds moved from the bank to the new borrower to the old borrower and back to the bank. The court readily found inapplicable the usual rule that a third-party transfer to a creditor not involving property of the debtor was not a preference,[175] given the interrelationship between the subsidiaries and the bank's form of structuring the transaction. The court accordingly held that the loan repayment was a preference under section 547 as well as a fraudulent transfer under section 548 of the Code.[176]

Even though the Fourth Circuit did not find it necessary to decide whether a subsidiary and its appendant second-tier subsidiary should be deemed a "single business enterprise," *Regal Ware, Inc. v. Fidelity Corp.*[177] should also be considered. In *Regal Ware*, the court found a preference where the subsidiary's transfer of accounts receivable to its second-tier subsidiary and retransfer to a sister subsidiary, which was the financing affiliate of the group, inured to the parent's benefit by protecting it against potential liability on its guaranty of the subsidiary's debts in preference to creditors of the subsidiary.[178]

These cases introduced a welcome recognition that the economics of the business, rather than legal formalities, should control the outcome.[179] They may herald a changing approach on the part of courts faced with allegedly fraudulent transfers involving corporate groups arising under the UFTA and the Code.

As noted, the insider-guarantor making a payment of the guaranteed obligation is subrogated to the rights of the creditor against the debtor. What is the status of the claim against the debtor to which the insider-guarantor has been subrogated? May this claim be set off against any claim by the debtor relating to prior fraudulent transfer or preferential transfer from the debtor to, or for the benefit of, the insider?

UFTA section 8(f)(1) contains provisions for limits of liability that must be considered in order to properly answer these questions. It provides that "[a] transfer is not voidable under Section 5(b): (1) to the extent the insider gave *new value* to or for the benefit of the debtor after the transfer was made unless the new value was secured by a valid lien."[180] This setoff enables the insider that has received a preferential transfer to reduce its liability to the extent of new value subse-

175 See supra notes 107-08 and accompanying text.

176 *American Properties*, 14 Bankr. at 642-44.

177 550 F.2d 934, 944 (4th Cir.), cert. denied, 434 U.S. 824 (1977).

178 Id. at 944-46.

179 See Littman, supra note 1, at 324, 335-36.

180 U.F.T.A. § 8(f), 7A U.L.A. 663 (1985) (emphasis added).

quently advanced to the debtor. An issue that may arise under section 8(f)(1) is whether a payment by an insider-guarantor honoring its guaranty of the debtor's obligation constitutes "new value" for purposes of section 8(f)(1). Although no cases have yet to be decided in connection with this issue under UFTA section 8(f), several cases have held under section 547(c)(4) of the Code—the companion provision to section 8(f)(1) and after which it was modeled—that such payments constitute "new value" within the meaning of the Code.[181] As the court stated in *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Ballanca Aircraft Corp.)*:[182]

> Upon honoring a guarantee, the guarantor gives new value for the benefit of a debtor and is thereby subrogated to the rights of the guaranteed supplier or lender. The supplier's or lender's claim to new value then vanishes and the guarantor becomes entitled to a section 547(c)(4) offset as to preferential transfers made prior to the original advance of new value by such supplier or lender.[183]

These decisions under UFTA section 8(f)(1)'s companion provision in the Code will probably influence the courts' construction of section 8(f)(1).

d. *Transfer by an Insider-Obligor in Satisfaction of Its Debt Guaranteed by the Debtor*

On the surface, a transfer by an insider-obligor in satisfaction of its debt guaranteed by the debtor seems to be the simplest situation of all. There has been no transfer of property by the debtor. Further, since the insider making the transfer was satisfying its own obligation for which it was primarily liable, no right of subrogation against the debtor arises. Accordingly, the estate of the debtor, far from being depleted, has been enhanced by the elimination of its contingent liability under its guaranty. Nevertheless, if transfer by the affiliated insider is attributed to the debtor, the transaction may still constitute a voidable preference.

e. *Position of Creditors Receiving Payments from Insiders in Reduction of Guaranteed Indebtedness Where Transfer Fraudulent*

Within the corporate group, the UFCA's preferential transfer

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[181] See, e.g., Bergquist v. Anderson-Greenwood Aviation Corp. (*In re* Bellanca Aircraft Corp.), 56 Bankr. 339, 394-95 (Bankr. D. Minn. 1985) (quoted infra at text accompanying note 183); Aetna Business Credit v. Hart Ski Mfg. Co. (*In re* Hart Ski Mfg. Co.), 7 Bankr. 465, 468-69 (Bankr. D. Minn. 1980).

[182] 56 Bankr. 339 (Bankr. D. Minn. 1985).

[183] Id. at 394.

provisions as well as the voidable preference provisions of section 547(b) of the Code, create a potential hazard with respect to the status of payments by one affiliate of indebtedness guaranteed by another affiliate that fall within the statutory provisions. These hazards face the *creditor* of guaranteed indebtedness as well as the *guarantor*. Following the provisions of section 550(a) of the Code,[184] UFTA section 8(b)(1) provides that in the case of a preferential transfer voidable under the UFTA, "the creditor may recover judgment for the value of the asset transferred . . . against: (1) the first transferee of the asset *or* the person for whose benefit the transfer was made."[185] This provision exposes an unrelated creditor who is the transferee of a proscribed transfer to possible liability.[186]

No cases have as yet construed UFTA section 8(b)(1). However, commentators have disagreed on the application of section 550(a) of the Code to an unrelated creditor-transferee of a proscribed transfer.[187] The numerous cases decided under the Code regarding this question have overwhelmingly held that the imposition of transferee liability upon an unrelated lender was discretionary under section 550(a) because of the use of the disjunctive in the statute. Courts have refused to impose liability on lenders in cases of preferential transfers involving insider-guarantors.[188] Only

184 11 U.S.C. § 550(a) (1982).

185 U.F.T.A. § 8(b)(1), 7A U.L.A. 662 (1985) (emphasis added).

186 UFTA § 8(a) contains an exception: "A transfer or obligation is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee." U.F.T.A. § 8(a), 7A U.L.A. 662 (1985). Since § 8(a) refers only to § 4(a)(1), the exception contained therein does not apply to transfers under §§ 4(a)(2), 5(a) or 5(b). See id. This provision differs from the exception contained in the Code. Section 550(b)(1) of the Code bars recovery from "a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided." 11 U.S.C. § 550(b)(1) (1982). The official comment to UFTA § 8(a) explains the omission of the reference to the voidability of the transfer language appearing in the Code. It terms such knowledge "inconsistent with the good faith" standard; further, it concludes that the court should not be required "to inquire into the legal sophistication of the transferee." U.F.T.A. § 8 comment 2, 7A U.L.A. 663 (1985).

187 Compare 4 Collier on Bankruptcy ¶ 550.02, at 550-5 to 6 (L. King 15th ed. 1987) and Nutovic, The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546 (a)(1), 41 Bus. Law. 175, 189 (1985) with Pitts, supra note 87, at 346-56.

188 E.g., Levit v. Melrose Park Nat'l Bank (*In re* V.N. Deprizio Constr. Co.), 58 Bankr. 478 (Bankr. N.D. Ill. 1986); *In re* Aerco Metals, Inc., 60 Bankr. 77 (Bankr. N.D. Tex. 1985); Schmitt v. Equibank (*In re* R.A. Beck Builder, Inc.), 34 Bankr. 888 (Bankr. W.D. Pa. 1983); Bakst v. Schilling (*In re* Cove Patio Corp.), 19 Bankr. 843 (Bankr. S.D. Fla. 1982); Seeley v. Church Bldgs. & Interiors, Inc. (*In re* Church Bldgs. & Interiors, Inc.), 14 Bankr. 128 (Bankr. W.D. Okla. 1981); cf. Goldberger v. Davis Jay Corregated Box Corp. (*In re* Mercon Indus.), 37 Bankr. 549 (Bankr. E.D. Pa. 1984) (creditors who are not insiders should be protected if effect otherwise would be to preferentially benefit insider-guarantors).

one jurisdiction has disagreed.[189]

C. *Guaranties of "Insider" Obligations*

As discussed above,[190] UFTA section 5(b) applies only to transfers and does not apply to guaranties. The issuance of guaranties is subject to the provisions of UFTA sections 4(a)(1) and 4(a)(2). Section 4(a)(1) applies to the issuance of a guaranty with an "actual intent to hinder, delay, or defraud" without regard to whether "reasonably equivalent value" was received in exchange.[191]

Section 4(a)(2) utilizes a constructive fraud standard. Instead of the "insolvency" standard of section 5(b), section 4(a)(2) applies to guaranties issued by a debtor with "unreasonably small . . . remaining assets," or that "intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due."[192] Further, under section 4(a)(2), the guaranty must have been issued "without receiving a reasonably equivalent value in exchange."[193] In the case of the issuance of a guaranty of antecedent indebtedness, the "reasonably equivalent value" standard clearly cannot be satisfied under section 4(a)(2). When new indebtedness is guaranteed, the validity of the upstream or cross-stream or other insider guaranties will depend, inter alia, on whether the guarantor receives "a reasonably equivalent value" in exchange for the financing to which the guaranty relates.[194]

In determining the "reasonably equivalent value" for a guaranty, the issue is obviously the consideration received by the guarantor, not the primary obligor. The cases construing "fair consideration" demonstrate that guaranties made for the benefit of third parties are not given for "reasonably equivalent value." The benefit must be to the guarantor.[195] Similarly, in the case of transfers, benefit must be to

189 Mixon v. Mid-Continent Sys., Inc. (*In re* Big Three Transp., Inc.), 41 Bankr. 16, 20-21 (Bankr. W.D. Ark. 1983). See First State Bank v. W.E. Tucker Oil (*In re* W.E. Tucker Oil Inc.), 42 Bankr. 898, 901-02 (Bankr. W.D. Ark. 1984) ("Property transferred within one year of the filing of the petition in violation of [the Code] may be recovered from an insider who has benefitted therefrom."); cf. Mixon v. Anderson (*In re* Ozark Restaurant Equip. Co.), 41 Bankr. 476 (Bankr. W.D. Ark. 1984), aff'd in part, rev'd in part, 61 Bankr. 750 (W.D. Ark. 1986) (in case involving preferential transfer, recovery allowed against creditor who was also an insider), aff'd, 816 F.2d 1222 (8th Cir. 1987).

190 See supra notes 97-100 and accompanying text.

191 U.F.T.A. § 4(a)(1), 7A U.L.A. 652 (1985).

192 UFTA § 4(a)(2) is quoted supra, at text accompanying note 103.

193 U.F.T.A. § 4(a)(2), 7A U.L.A. 653 (1985).

194 See Blumberg, Corporate Groups: Bankruptcy, supra note 6, at 285-398; Littman, supra note 1; Ragusin, supra note 14; Rosenberg, supra note 14; Walls, supra note 75, at 224-35; Note, Section 548(a)(2), supra note 14.

195 See *In re* Nelsen, 24 Bankr. 701, 702 (Bankr. D. Or. 1982); Zellerbach Paper Co. v.

the transferor.[196] The critical question under section 4(a)(2) is when financing assistance to the affiliate will benefit the guarantor. Thus, if a portion of the proceeds of the financing is paid to the guarantor, the intragroup transfer cases demonstrate that this circumstance obviously must be taken into account.[197] If other tangible and quantifiable benefits move to the guarantor, those also may constitute "reasonably equivalent value."[198]

In most intragroup guaranty cases, however, the only objective realized by the guarantor is the strengthening of the financial position of an affiliate and therefore of the corporate group of which it is a part.[199] This may be of major importance in a group that is economically integrated and where group allocation of resources prevails within the enterprise—but will it satisfy the statute? In *Rubin v.*

Valley Nat'l Bank, 13 Ariz. App. 431, 477 P.2d 550 (1970); 4 Collier on Bankruptcy ¶ 67.33, at 514.1 to 515 (J. Moore & L. King 14th ed. 1978); Annotation, Transaction in Consideration of Discharge of Antecedent Debt Owed by One Other Than Grantor as Based on "Fair Consideration" under Uniform Fraudulent Conveyance Act, 30 A.L.R.2d 1209 (1953).

A case arising under the Code and construing "reasonably equivalent value" has reached the same conclusion. Ear, Nose & Throat Surgeons, Inc. v. Guaranty Bank & Trust Co. (*In re* Ear Nose & Throat Surgeons, Inc.), 49 Bankr. 316 (Bankr. D. Mass. 1985).

196 Bullard v. Aluminum Co. of Am., 468 F.2d 11 (7th Cir. 1972); United Towing Co. v. Phillips, 242 F.2d 627 (5th Cir.), cert. denied, 355 U.S. 861 (1957); *In re* Security Prods. Co., 310 F. Supp. 110 (E.D. Mo. 1969); Bennett v. Rodman & English, Inc., 2 F. Supp. 355 (E.D.N.Y.), aff'd per curiam, 62 F.2d 1064 (2d Cir. 1932); Wells Fargo Bank v. Desert View Bldg. Supplies, Inc. (*In re* Desert View Bldg. Supplies, Inc.), 14 C.B.C. 171, 178 (Bankr. D. Nev. 1977), aff'd, 475 F. Supp. 693 (D. Nev. 1978), aff'd mem., 633 F.2d 225 (9th Cir. 1980); Hall v. Arthur Young & Co. (*In re* Computer Universe, Inc.), 58 Bankr. 28 (Bankr. M.D. Fla. 1986); Bailey v. Commerce Fed. Sav. & Loan Ass'n (*In re* Butcher), 51 Bankr. 61 (Bankr. E.D. Tenn. 1985). See Coors, Inc. v. Bank of Longview (*In re* Coors of North Mississippi, Inc.), 66 Bankr. 845 (Bankr. N.D. Miss. 1986).

197 Klein v. Tabatchnick, 610 F.2d 1043 (2d Cir. 1979) (transfer); Mayo v. Pioneer Bank & Trust Co., 270 F.2d 823 (5th Cir. 1959) (same), cert. denied, 362 U.S. 962 (1960); Beemer v. Walter E. Heller, Inc. (*In re* Holly Hill Medical Center, Inc.), 44 Bankr. 253 (Bankr. M.D. Fla. 1984) (same); cf. McNellis v. Raymond, 287 F. Supp. 232, 238-39 (N.D.N.Y. 1968) (transfer), aff'd in relevant part, 420 F.2d 51 (2d Cir. 1970); Ear, Nose & Throat Surgeons, Inc. v. Guaranty Bank & Trust Co. (*In re* Ear, Nose & Throat Surgeons, Inc.), 49 Bankr. 316 (Bankr. D. Mass. 1985) (guaranty).

As discussed supra notes 37-38 and accompanying text, the draftsmen of the Minnesota statute authorizing intragroup guaranties under its corporation law reached the same conclusion, stating: "The ability to bolster the finances of a related corporation . . . is important because these related corporations are often part of one economic unit within which artificial distinctions should not prevent internal transfers of funds." Minn. Stat. Ann. § 302A.501, reporter's notes-general comment (West 1985).

198 See Howco Leasing Corp. v. Alexander Dispos-Haul Sys., Inc. (*In re* Alexander Dispos-Haul Sys., Inc.), 36 Bankr. 612, 616 (Bankr. D. Or. 1983). See also Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 991-94 (2d Cir. 1981) (section 67d "requires only 'fair' consideration, not a penny-for-penny exchange.").

199 Even in the leveraged buyout, this strengthening will not occur. In such acquisitions, the assets or credit of the companies being acquired are committed to the payment of the purchase price; the financial position of the group is weakened, not enhanced.

Manufacturers Hanover Trust Co.,[200] a case decided under the Bankruptcy Act, the Second Circuit held that such benefit was too intangible to qualify as "fair consideration" for purposes of the statute. Some commentators are in accord.[201]

Where, however, the court is willing to accept enterprise law and look at the impact of the financing on the group, corporate cross-stream and upstream guaranties can readily satisfy the Uniform Acts. Thus, in *Telefest, Inc. v. VU-TV, Inc.*,[202] the court held that an upstream guaranty within a corporate group used to assist the parent in a financing that would benefit the group as a whole provided sufficient indirect benefit to the subsidiary to satisfy the "fair consideration" requirement under the UFCA.[203] Firmly adopting an enterprise view, the *Telefest* court said:

> In any event, the notion that a benefit accrues to a subsidiary only when there is a direct flow of capital to that entity [as] the result of its guarantee of a loan to its parent is inhibitory of contemporary financing practices, which recognize that cross-guarantees are often needed because of the unequal abilities of interrelated corporate entities to collateralize loans. . . . Contemporary corporate practices of vertically and horizontally dividing the integrated operations of what is essentially one enterprise among a number of legally distinct entities, making it necessary for financial institutions to frequently obtain "upstream" and "cross-stream" collateralizations, demand that a broad view of "fair consideration" be taken.[204]

Other possible sources of "reasonably equivalent value" are the right of subrogation against the primary obligor and the right to contribution from the co-guarantors. Where the primary obligor is solvent, the right of subrogation fully offsets the liability under the guaranty and should constitute "reasonably equivalent value." Indeed, a number of courts have so held.[205] The right to contribution is another matter. Even if the co-guarantor is solvent, the contribution

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[200] 661 F.2d 979.

[201] See Coquillette, supra note 3, at 453; Rosenberg, supra note 14, at 243-45; but see Walls, supra note 75, at 224-35 (upstream guaranty "waging an uphill battle"). See also United States v. Gleneagles Inv. Co., 565 F. Supp. 556, 576-77 (M.D. Pa. 1983) (court did not reject this theory upon consideration, but found it unnecessary to pass on its validity), modified on other grounds sub nom. United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986), cert. denied, 107 S. Ct. 3229 (1987).

[202] 591 F. Supp. 1368 (D.N.J. 1984).

[203] Id. at 1378-81.

[204] Id. at 1379-80.

[205] Id. at 1375 n.5; Howco Leasing Corp. v. Alexander Dispos-Haul Sys., Inc. (*In re* Alexander Dispos-Haul Sys., Inc.), 36 Bankr. 612, 616 (Bankr. D. Or. 1983); *In re* Nelsen, 24 Bankr. 701, 701 (Bankr. D. Or. 1982). See Coquillette, supra note 3, at 453 n.68.

can only partially reduce the liability under the guaranty. Since in all circumstances, notwithstanding the solvency of the co-guarantor, the debtor will have some net liability, it is difficult to see how "reasonably equivalent value" can be present.[206] The definition of "asset" in UFTA section 1(2) has been drafted so that a "contingent claim of a surety for reimbursement, contribution, or subrogation may be counted as an asset for the purpose of determining whether the holder of the claim is solvent as a debtor."[207]

D. *Revised Standard for Determining When an Obligation Is Incurred (Section 6(5))*

UFTA section 6(5) provides that "an obligation is incurred: if oral, when it becomes effective," or, if written, "when . . . delivered."[208] This section is intended to "resolve uncertainty arising from" the Second Circuit's decision in *Rubin v. Manufacturers Hanover Trust Co.*,[209] "insofar as [*Rubin*] holds that an obligation of guaranty may be deemed to be incurred when advances covered by the guaranty are made rather than when the guaranty first became effective between the parties."[210] The *Rubin* case has generally been accepted by the courts,[211] and its construction of the Bankruptcy Act will likely prevail under the Code as well.

When a creditor bargains for a guaranty, this provision in the UFTA eliminates the uncertainty arising from the possibility that the financial condition of the guarantor will worsen during any interval between the execution of the financing agreement and the advances made thereunder to the point where it renders fraudulent under the UFCA payments honoring a guaranty that was valid when made. It therefore makes upstream and cross-stream (and other) guaranties more marketable in packaging group financing by relieving lenders of the ongoing burden of having to continue to police the condition of the guarantor and its affiliates to determine whether their condition at the time of the advance would render the guaranty fraudulent. Fur-

206 The evaluation of the right of subrogation and the right to contribution for purposes of "reasonably equivalent value" presents a very different question than their value for purposes of determining the guarantor's solvency. For determination of solvency, the right to contribution is an asset as far as it goes.

207 U.F.T.A. § 1 comment 2, 7A U.L.A. 645 (1985).

208 Id. § 6(b), 7A U.L.A. 659 (1985).

209 661 F.2d 979 (2d Cir. 1981) (decided under the Bankruptcy Act).

210 U.F.T.A. § 6 comment 3, 7A U.L.A. 639, 660 (1985).

211 See, e.g., Ear, Nose & Throat Surgeons, Inc. (*In re* Ear Nose & Throat Surgeons, Inc.), 49 Bankr. 316 (Bankr. D. Mass 1985); Corporate Jet Aviation, Inc. v. Vantress (*In re* Corporate Jet Aviation, Inc.), 45 Bankr. 629 (Bankr. N.D. Ga. 1985); Beemer v. Walter E. Heller & Co. (*In re* Holly Hill Medical Center, Inc.), 44 Bankr. 253 (M.D. Fla. 1984).

ther, the earlier the guaranty is deemed effective, the sooner section 547(b)'s ninety-day period of vulnerability rendering preferences voidable for others than insiders commences and expires.

It is doubtful whether the inclusion of section 6(5) is desirable. The wisdom of adopting a rule for purposes of the UFTA that is different from the rules governing comparable situations under the Code is open to question. Indeed, the motivation for the UFTA was the commendable interest in harmonizing state law with the Code. Section 6(5) is a departure from this sound principle.

E. *Shortened Periods of Limitation and Extinguishment of Right Not Merely Remedy*

The issue of the appropriate period of limitations for actions under the UFTA is one of considerable importance because it provides bankruptcy trustees as well as creditors a significantly longer time to pursue remedies than the much more restricted period contained in the Code and the Bankruptcy Act. The Code only renders fraudulent those transfers taking place within one year of the filing of the petition.[212] In contrast, state laws under the UFCA had generally provided for much longer periods. Since section 544(b) of the Code[213] authorizes the trustee to pursue fraudulent transfers under state law, reliance on such state law provided an important additional remedy for the trustee to sidestep the Code's one-year limitation contained in section 548.

However, there was an anomaly in state law: the periods of limitation for pursuing rights under the UFCA were not uniform. For example, New York[214] and Pennsylvania[215] provided for limitations periods of six years, and Texas[216] for four years; whereas Missouri provided for ten years for land and five years generally.[217] Further, the official comment to the UFTA points out that the state statutes

212 11 U.S.C. § 548(a) (1982 & Supp. III 1985).

213 11 U.S.C. § 544(b) (1982).

214 N.Y. Civ. Prac. L. & R. 213(8) (McKinney Supp. 1986); see Dolmetta v. Uintah Nat'l Corp., 712 F.2d 15, 20 (2d Cir. 1983); Quadrozzi Concrete Corp. v. Mastroianni, 56 A.D.2d 353, 358, 392 N.Y.S.2d 687, 690 (1977); Martin v. Martin, 29 A.D.2d 864, 866, 288 N.Y.S.2d 374, 376 (1968), modified, 23 N.Y.2d 858, 245 N.E.2d 801 (1969).

215 42 Pa. Cons. Stat. Ann § 5527 (Purdon Supp. 1987); see United States v. Gleneagles Inv. Co., 565 F. Supp. 556, 583 (M.D. Pa. 1983), modified sub nom. United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986), cert. denied, 107 S. Ct. 3229 (1987).

216 Tex. Bus. & Com. Code Ann. § 24.02 to .03 (Vernon 1968); Tex. Civ. Prac. & Rem. Code Ann. § 16.051 (Vernon 1986); see Creel v. Lawler, 462 F. Supp. 118, 120 (N.D. Tex. 1978); Hoerster v. Wilke, 138 Tex. 263, 158 S.W.2d 288 (1942); Conner, supra note 62, at 809.

217 Mo. Ann. Stat. § 516.110 to .120 (Vernon 1952); see Coleman v. Alderman, 357 Mo. 758, 210 S.W.2d 994 (1948).

not only lacked uniformity but were frequently subject to uncertainties in their application.[218]

UFTA section 9 commendably introduces for sections 4(a)(2) and 5(a) a uniform statutory period of four years after the transfer was made or the obligation was incurred.[219] In the case of section 4(a)(1)—involving "actual intent to hinder, delay, or defraud"[220]—it also provides for an additional period of one year after discovery where the transfer or obligation was not or could not reasonably have been discovered by the claimant until later than four years.[221]

In contrast to the four-year period adopted generally, section 9(c) restricts the period to one year in the case of transfers under section 5(b).[222] This restriction conforms to the one-year period in which insider transfers constitute voidable preferences for purposes of section 547(b)(4) of the Code. Although utilization of the one-year provision in the Code is understandable both in the Code and in the UFTA, it loses sight of the derivation of Code sections 547(b)(4) and 5(b). The one-year provision became necessary because insider transactions that would have constituted fraudulent transfers notwithstanding adequate consideration by reason of the "good faith" element of "fair consideration" would otherwise have become invulnerable as a result of the substitution of "reasonably equivalent value" for "fair consideration." As noted, under the UFCA such insider transactions were subject to the extended period of limitations for fraudulent transfers varying from four to even ten years depending on the state.[223] Although UFTA section 5(b) was included to render fraudulent voidable preferential transfers to insiders as UFCA sections 3 and 4 had done, UFTA section 9(c) takes a step backward by singling out such tranfers and providing a special one-year limitation period for them.[224] This special one-year period contrasts with the four-year period adopted for all other fraudulent transfers and an even more liberal limitation period in most states under the UFCA.

Section 9 accomplishes another significant change by making it clear that the lapse of the statutory limitation period bars the right, not merely the remedy. As noted in the official comment,[225] this provision was inserted to reject the contrary rule adopted in *United States*

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218 See U.F.T.A. § 9 comment 2, 7A U.L.A. 666 (1985).
219 Id. § 9(b), 7A U.L.A. 665 (1985).
220 Id. § 4(a)(1), 7A U.L.A. 652 (1985).
221 Id. § 9(a), 7A U.L.A. 665 (1985).
222 Id. § 9(c).
223 See supra notes 214-18 and accompanying text.
224 U.F.T.A. § 9(c), 7A U.L.A. 665 (1985).
225 Id. § 9 comment 1, 7A U.L.A. 666 (1985).

v. Gleneagles Investment Co.,[226] where a federal district court held that a state statute of limitations did not apply to an action by the United States based on the UFCA.[227]

CONCLUSION

The economic reality of corporate groups is plain. Enterprises organized in the form of a group of companies conduct their affairs to achieve performance for the group as a whole. Although the traditional corporation law has viewed each of the corporate affiliates within the group as a separate legal entity with its own separate rights and obligations, the law has slowly been adapting to the changing reality of economic organizations with increasing reliance on "piercing-the-veil jurisprudence" or enterprise law. In the areas of insolvency and bankruptcy, this process has been evident with increasing recognition of the potential problems that can arise in transactions involving the debtor and its controlling shareholders and affiliates, problems which are presented by almost every case involving corporate groups. This is evident not only in more sophisticated judicial decisions but also in more sophisticated statutes. The provisions of the Code and the UFTA reflect this development.

Upstream and cross-stream guaranties occupy an important place in the process. They represent the inevitable response of lenders and corporate groups in fashioning group financing to harness the economic strength of a group to support the financing which will effectuate the objectives of the group, although it may not affect all constituent companies, or even all guarantor-constituents, to the same degree. It is important that this process be encouraged in order to permit the more effective functioning of the economic system. It is equally important to provide equivalent protection for creditors dealing with group constituents against insider manipulation to their detriment as well as against economic consequences from legal rules contrary to their expectations. This is a continuing challenge to the law. The UFTA and the changes it incorporates with respect to insider transactions are, notwithstanding minor areas of disagreement, a considerable step forward in helping meet that challenge.

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226 565 F. Supp. 556 (M.D. Pa. 1983), modified sub nom. United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986), cert. denied, 107 S. Ct. 3229 (1987).

227 Id. at 583.