

The Florida Bar Business Law Section
Bankruptcy-UCC Committee
Subcommittee on Protecting Charities from State Fraudulent Transfer Statute

Patrick Scott, Subcommittee Chair

Florida's Fraudulent Transfers Act

Generally: In 1987 Florida adopted the Uniform Fraudulent Transfers Act, which has also been adopted by 43 other states; the remaining states have adopted some variation of the older Uniform Fraudulent Conveyances Act. The most substantial difference among the states is the limitations period for creditors to bring actions to avoid transfers, Florida's being four years.

Exposure of Charities: No state's version of the UFTA was interpreted to give any special protection to charitable organizations, so it is commonly held that charitable contributions made by insolvent debtors are transfers avoidable under the UFTA upon the request of creditors. In Ponzi scheme cases, courts have held that even absent a showing of insolvency large contributions to a charity are made to help draw in more victims, furthering the Ponzi scheme and creating a presumption that the transfer was made with the intent to hinder, delay, or defraud creditors, and that the contributions are avoidable on that basis as well. Receivers, as in the *Arthur Nadel* Ponzi scheme case, have been expected to bring such actions to recover monies lost collectively by defrauded investors and unpaid creditors.

The Bankruptcy Code's Fraudulent Transfers Provisions

Generally: Section 548(a) of the Bankruptcy Code provides avoidance powers to bankruptcy trustees that are substantially similar to those the UFTA provides to creditors and receivers, with the ability to avoid transactions made as long as two years prepetition. *11 U.S.C. §548(a)*. The Code also gives trustees the powers that creditors would have to avoid transfers under the UFTA. *11 U.S.C. §544(b)*.

Exposure of Charities: In 1998, Congress provided limited relief for charities, modifying section 548 to immunize *cash* transfers made by an *individual* debtor to an IRS-recognized charity, with a minor limitation on dollar amount.¹ And it modified section 544(b) so that bankruptcy

¹ The contribution must not exceed the greater of 15% of the debtor's gross income for that year or such amount as was consistent with the practices of the debtor in making charitable contributions. *11 U.S.C. §548(a)(2)*. The law which modified the Bankruptcy Code was the Religious Liberty and Charity Donation Protection Act of 1998, which was a response to the concern that an earlier statute immunizing religious tithing might be held unconstitutional. See *Christians v. Crystal Evangelical Free Church (In re Young)*, 148 B.R. 886 (Bankr. D. Minn. 1992), *aff'd*, 152 B.R. 939 (D. Minn. 1993) (contributions lacked reasonably equivalent value), *rev'd on other grounds*, 82 F.3d 1407, 1415-17 (8th Cir. 1996) (trustee's recovery of church donations by debtors, which were avoidable transfers because the debtors did not receive services in exchange for their contributions, held to violate the Religious Freedom Restoration Act) *vacated and remanded* 117 S. Ct. 2502 (1997) (mem.) (remanded in light of *City of Boerne v. Flores*, 521 U.S. 507 (1997), held, Religious Freedom Restoration Act unconstitutional); on remand, 141 F.3d 854 (8th Cir. 1998) (2-1) (held, RFRA constitutional exercise of congressional power with respect to federal legislation violated neither separation of powers doctrine nor Establishment Clause of First Amendment; earlier decision reinstated), cert. denied, 119 S. Ct. 43 (1998).

trustees' actions against charities for transfers made during the two years prepetition would not be restricted by the UFTA any more than Congress had restricted them. So any greater restrictions that states place upon fraudulent transfer actions against charities are not limitations upon bankruptcy trustees for the two year reach-back period.

Minnesota's Law

Last May, in response to suits brought by bankruptcy trustee in the *Thomas Petters* Ponzi scheme case against a diabetes research foundation and other charitable organizations, Minnesota became the first state to modify the UFTA to impose any restrictions on fraudulent transfer actions against charities. Minnesota has a six-year reach-back statute. Its law now provides that all transfers to IRS-recognized charities are immunized from avoidance so long as the charity did *not*, within 60 days after the transfer, have reason to believe that the transfer was made with fraudulent intent or that the debtor was insolvent or lacking the ability to pay its debts as they became due or lacking in adequate capital. The law naturally would be preempted in bankruptcy proceedings as to transfers made during the two years preceding the bankruptcy petition.

Florida Legislative Efforts to Protect Charities from Fraudulent Transfers Act

At the urging of Sarasota attorney John Patterson, state representatives Steube and Pilon last year proposed a bill in the Florida legislature limiting the four year reach-back to two years where the transferee was a charitable organization and imposing other restrictions. *HB 451 (2012)*. Senator Bennett then proposed a bill that would make all transfers to IRS §501(c)(3) and (4) charities immune and would make the statute retroactive to past transfers. *SB 458 (2012)*. While these bills were pending, Mr. Patterson worked with some members of this Bar subcommittee to come up with a strike-all amendment to the Steube-Pilon bill. The Bankruptcy-UCC Committee had already approved the Patterson language—matching the Bankruptcy Code's clause—by a voice vote, but Mr. Patterson's draft also provided a *full* defense to charities which took donations in good faith more than two years before suit (and two other defenses which have since been withdrawn from the draft). At that point, Representative Eisnaugle proposed a strike-all amendment to the Steube-Pilon bill which would amend Florida's UFTA to limit the liability of IRS-recognized charities under the UFTA to the greater of the extent to which the transfer increased the charity's net worth that year or the factor that represented the ratio of the charity's administrative and non-charitable expenditures to all expenses that year. None of the bills was voted on in either house.

The 2013 Legislature

Senator Detert, with the input of a handful of members of this subcommittee, prefiled SB 102 on December 11, 2012, with the intention of immunizing charities from clawbacks of any transfers they received without knowledge of the donor's fraudulent intent or the donor's financial problems, but dollar-limiting the protection as to contributions from natural persons during the two years immediately preceding in a way that matches the Bankruptcy Code's limited immunity during that period. [The bill does not limit the protection where the debtor was a business entity, only where it was a natural person; perhaps this was an oversight].

A copy of the bill is attached. This Bar subcommittee would like input from the members of the Business Law Section, on different options available for the protection (or not) of charities from avoidance under fraudulent transfer law. The link below is to a questionnaire on the SurveyMonkey site that will tabulate the results for our committee to report to the meetings of the Bankruptcy-UCC committee at its meeting in Orlando in two weeks. The survey has only nine questions, and should take only five minutes to fill out.

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