

ELEMENTS OF PROOF FOR FRAUDULENT TRANSFERS IN FLORIDA: *How to Determine if a Transfer Was Fraudulent*

Prepared by:
Charles B. Jimerson, Esq.
Daniel L. Buchholz, J.D. Candidate
Jimerson & Cobb, P.A.



LORMAN[®]

Published on www.lorman.com - August 2017

Elements of Proof for Fraudulent Transfers in Florida: How to Determine if a Transfer Was Fraudulent, ©2017 Lorman Education Services. All Rights Reserved.

INTRODUCING

Lorman's New Approach to Continuing Education

ALL-ACCESS PASS

The All-Access Pass grants you **UNLIMITED** access to Lorman's ever-growing library of training resources:

- ☑ Unlimited Live Webinars - 120 live webinars added every month
- ☑ Unlimited OnDemand and MP3 Downloads - Over 1,500 courses available
- ☑ Videos - More than 700 available
- ☑ Slide Decks - More than 1700 available
- ☑ White Papers
- ☑ Reports
- ☑ Articles
- ☑ ... and much more!

Join the thousands of other pass-holders that have already trusted us for their professional development by choosing the All-Access Pass.



Get Your All-Access Pass Today!

SAVE 20%

Learn more: www.lorman.com/pass/?s=special20

Use Discount Code Q7014393 and Priority Code 18536 to receive the 20% AAP discount.

*Discount cannot be combined with any other discounts.

ELEMENTS OF PROOF FOR FRAUDULENT TRANSFERS IN FLORIDA: HOW TO DETERMINE IF A TRANSFER WAS FRAUDULENT

Written by: Charles B. Jimerson, Esq. and Daniel L. Buchholz, J.D. Candidate – 3/14/17

Creditors may become frustrated when they discover a debtor has engaged in an unfair transaction that hampers their ability to collect payment. However, creditors are not without remedy in the event that there has been some funny business with the debtor's finances. Regardless of the debtor's intentions behind the questionable transaction, Florida's Uniform Fraudulent Transfer Act ("FUFTA") permits courts to set aside transfers that are either actually or constructively fraudulent. Of course, many creditors and attorneys are aware that FUFTA is a "powerful remedy." See Brandon C. Meadow's in-depth article, Are Florida's Fraudulent Transfer Claims Subject to Equitable Tolling? Yet many Florida attorneys may be unaware that a transfer was fraudulent until it is too late. Therefore, Florida attorneys must acquire a thorough understanding of FUFTA in order to ensure their clients' interests are fully protected. This article provides guidance on establishing a prima facie case for both actual and constructive fraud under FUFTA.

ACTUAL FRAUD

Under FUFTA, a transfer by a debtor is fraudulent and subject to avoidance if made by the debtor with actual intent to hinder, delay, or defraud any creditor. Therefore, actual fraud focuses on the debtor's subjective intent.

Florida courts have held that to establish a prima facie case of actual fraud, a plaintiff must prove (1) there was a creditor to be defrauded; (2) there was a transfer of property that could have been applied to payment of the debt due; and (3) there was a debtor intending fraud. See *Branch Banking & Trust Co. v.*

Hamilton Greens, LLC, 2016 U.S. Dist. LEXIS 77087, at *29 (S.D. Fla. Jan. 13, 2016).

First, the court must determine whether there was a creditor to be defrauded. A “creditor” is defined as “a person who has a claim.” Fla. Stat. § 726.102. This definition is broad, as a “claim” is defined as merely “a right to payment,” regardless of that right’s liquidity, maturity, securitization, or contingency. *Id.* Moreover, when the claim arose is irrelevant as there is no requirement that the claim arise before the transfer was made.

Next, the court must determine whether there was a transfer of property that could have been applied to payment of the debt. Like the definition of “claim,” the term “transfer” is given a very broad meaning, as it includes every mode of disposing of an asset, and it is not limited to direct transactions made by the debtor. See Nationsbank, N.A. v. Coastal Utils., Inc., 814 So. 2d 1227, 1230 (Fla. 4th DCA 2002).

Finally, and most importantly, the court must determine whether there was a debtor intending fraud. This requires proof of the subjective intention of the debtor in making the transfer. However, people rarely admit or document their illegal intentions. FUFTA recognizes this difficulty, and lists several circumstantial factors for courts to consider in determining whether a transfer was made with intent to defraud creditors. Courts have routinely referred to these factors as “badges of fraud.” The following badges of fraud are red flags that allow courts to infer the transferor’s intent:

- **Transfer to insiders.** The debtor transferred assets to a relative, friend, or another “insider” (e.g., a corporation of which the debtor is a director or officer).
- **Retention of possession:** The debtor transferred the assets to another person, but retained possession of them.

- **Concealment of transfer:** The debtor hid the transfer as another type of activity.
- **Notice of pending litigation:** The debtor had been sued or threatened with suit before the transfer was made.
- **Transfer of entire estate:** The debtor transferred all or substantially all of its assets.
- **Absconding:** The debtor tried to avoid detection of the transaction or otherwise consummated the transaction in haste in order to liquidate the assets.
- **Removal or concealment of assets:** The debtor transferred the assets to another jurisdiction or entity with little notice or preparation.
- **Value of assets transferred:** The debtor received less than reasonably equivalent value for the property transferred.
- **Insolvency:** The debtor was insolvent or became insolvent at the time of the transfer.
- **Timing of transfer:** The debtor incurred a substantial debt shortly before or after the transfer occurred.
- **Transfer of essential assets:** The debtor transferred the essential assets of the business to a lienor who transferred the assets to an "insider."

Fla. Stat. § 726.105(2).

This list is not intended to be exclusive and no badge alone is dispositive. Instead, courts look to the totality of the circumstances surrounding the transfer. In re Ramsurat, 361 B.R. 246, 253 (Bankr. M.D. Fla. 2006). However, "while a single badge of fraud may create only a suspicious circumstance, several of them together may afford a basis to infer fraud." Mejia v. Ruiz, 985 So. 2d 1109, 1113 (Fla. 3d DCA 2008). Indeed, evidence of multiple badges creates a prima facie case and raises a rebuttable presumption that the transaction is void. Nat'l Mar. Servs. v. Straub, 979 F. Supp. 2d 1322, 1328 (S.D. Fla. 2013).

CONSTRUCTIVE FRAUD: OVERVIEW

Unlike actual fraud, constructive fraud does not focus on the debtor's subjective intent. Indeed, instead of inferring the debtor's fraudulent intent, constructive fraud conclusively infers fraud in defined circumstances.

To establish a prima facie case for constructive fraud, a plaintiff must prove (1) the debtor did not receive reasonably equivalent value in exchange for the transfer; and (2) the debtor:

(a) 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 ("Unreasonably Small Capital");

(b) 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 ("Cash Flow Insolvency"); or

(c) if a creditor's claim arose before the transfer was made or the obligation was incurred, was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation ("Balance Sheet Insolvency").

See Fla. Stat. §§ 726.105(1)(b), 726.106(1).

Additionally, a transfer may be set aside for constructive fraud without proof that the debtor did not receive reasonably equivalent value if the transfer was made to an insider while the debtor was insolvent or rendered insolvent by the transfer and the insider had reasonable cause to believe the debtor was insolvent.

CONSTRUCTIVE FRAUD: ESTABLISHING REASONABLY EQUIVALENT VALUE

For most claims of constructive fraud, the first step in the analysis is to determine whether the debtor received reasonably equivalent value in exchange for the transfer.

Under Section 726.104(1), “value” is given in exchange for a transfer when property is transferred or an antecedent debt is satisfied. However, except in limited circumstances, “reasonably equivalent” is not defined in FUFTA, but is left to judicial interpretation. Therefore, whether value is “reasonably equivalent” must be determined on a case-by case basis and is largely a question of fact. In re TOUSA, Inc., 680 F.3d 1298, 1311 (11th Cir. 2012); In re Dondi Fin. Corp, 119 B.R. 106, 109 (Bankr. N.D. Tex. 1990). However, in general, transfers made or obligations incurred solely for the benefit of third parties do not furnish reasonably equivalent value. *In re Amelung*, 2010 Bankr. LEXIS 1220, at *10-11 (Bankr. S.D. Fla. Apr. 7, 2010).

To determine if the value was “reasonably equivalent,” Florida courts focus on the “economic reality” of the situation, and consider factors such as the good faith of the parties, the disparity of the fair value of the property and what the debtor actually received, and whether the transaction was at arm’s length. See In re Miami General Hosp., Inc., 124 B.R. 383, 394 (Bankr. S.D. Fla. 1991); In re Dealers Agency Services, Inc., 380 B.R. 608, 619 (Bankr. M.D. Fla. 2007).

CONSTRUCTIVE FRAUD: ESTABLISHING INSOLVENCY

For the next step of the analysis, courts will look at the debtor’s financial condition during and after the transfer. Financially secure and solvent debtors are free to make gifts or other transfers for inadequate consideration, without their creditors filing suit. Therefore, to establish constructive fraud, proof that the debtor did not receive reasonably equivalent value in exchange for the property transferred is not enough.

Instead, if the creditor’s claim arose after the transfer was made, the creditor must prove either of the following in addition to establishing that the debtor did not receive reasonably equivalent value: Unreasonably Small Capital or Cash Flow Insolvency. Alternatively, if the creditor’s claim arose before the transfer was

made, the creditor must prove any of the following in addition to establishing that the debtor did not receive reasonably equivalent value: Unreasonably Small Capital, Cash Flow Insolvency, or Balance Sheet Insolvency.

Balance Sheet Insolvency

FUFTA recognizes two basic types of insolvency. The first of these is “balance sheet” insolvency, which focuses on the debtor’s assets and liabilities. The test for balance sheet insolvency is simple: if the debtor’s liabilities exceed the debtor’s assets as on the date of the challenged transfer, the debtor is insolvent. See In re Commercial Fin. Servs., Inc., 350 B.R. 520, 541 (Bankr. N.D. Okla. 2005).

The court will compare the fair market value of the debtor’s assets with the stated value of the debtor’s liabilities. In re Winstar Comm’ns, Inc., 348 B.R. 234, 247 (Bankr. D. Del. 2005). However, certain assets are not included in the analysis such as, property encumbered by a valid lien and certain exempt property. Fla. Stat. § 726.102(2).

Cash Flow Insolvency

The second type of insolvency recognized by FUFTA is “cash flow” insolvency. Unlike the balance sheet test, which looks at the debtor’s total assets and liabilities, the cash flow test looks at whether the debtor is generally paying its debts as they come due. Fla. Stat. § 726.103(2). Indeed, when a debtor is not generally paying its debts when due, there is a presumption of insolvency. *Id.*

The cash flow test does not require the creditor prove the debtor intended to incur more debts than it could pay as they come due. Evidence that the debtor “reasonably should have believed” it would be unable to pay the debts as they came due is sufficient under the cash flow test. However, because of the subjective nature of the inquiry, this test is rarely litigated. In re Suburban Motor Freight, Inc., 124 B.R. 984, n.4 (Bankr. S.D. Ohio 1990).

Unreasonably Small Capital

In addition to the two types of insolvency, FUFTA creates liability under the “unreasonably small capital” test for a financial condition short of insolvency, where the debtor has an “inability to generate sufficient profits to sustain operations.” Moody v. Security Pacific Business Credit, Inc., 971 F.2d 1056, 1070 (3d Cir. 1992). The unreasonably small capital test recognizes that such inability to generate sufficient profits must precede an inability to pay obligations as they become due (i.e., Cash Flow Insolvency). *Id.*

To determine if the debtor has adequate capital, courts consider all reasonably anticipated sources of operating funds, including cash from operations and accounts receivable, and the availability of credit to the debtor. See Peltz v. Hatten, 279 B.R. 710, 745 (Bankr. D. Del. 2002); *Moody*, 971 F.2d at 1073. The essential issue is whether the court believes it was foreseeable at the time of the transaction that the debtor would have unreasonably small capital to carry out its business.

CONSTRUCTIVE FRAUD: PREFERENCE TO CREDITORS

Normally, the law of fraudulent conveyance is concerned with transfers that hinder the creditors of a debtor as a group. However, satisfying the claim of any creditor, whether an inside creditor or not, does not hinder the efforts of the creditors as a group. Nonetheless, FUFTA recognizes a sense of suspicion with transfers that are made to insiders.

Accordingly, under Section 726.106(2), a creditor whose claim arose before the transfer was made may establish constructive fraud by proving:

- (1) the debtor was insolvent at the time of the transfer (“Balance Sheet Insolvency”);
- (2) the transfer was made to an insider for an antecedent debt; and

(3) the insider had reasonable cause to believe the debtor was insolvent.

If the debtor is an individual, the term “insider” not only includes relatives and friends of the debtor, but extends to partnerships and corporations where the debtor is a general partner, or a director or officer, respectively. Fla. Stat. § 726.102(8)(a). If the debtor is a corporation or a partnership, management level positions such as officers, directors, and general partners are all considered insiders. Fla. Stat. § 726.102(8)(b)-(c).

Most importantly, the creditor need not prove the insider’s state of mind; evidence that the insider had “reasonable cause” to know that the debtor was insolvent is sufficient. However, FUFTA does provide a safe harbor provision that immunizes a transfer to an insider from avoidance. See Fla. Stat. § 726.109(6) (immunizing transfers to insiders in the ordinary course of business, where new value was given, or if made pursuant to a good faith effort to rehabilitate the debtor).

CONCLUSION

FUFTA provides creditors with various rights and options to unwind transfers and obtain payback against debtors who engaged in unfair transactions that hampered their ability to collect from the debtor. See [Charles B. Jimerson’s blog post on the various remedies under FUFTA, Remedies for Creditors Under FUFTA Chapter 726 – Part I: Who May Be Liable](#). Therefore, it is essential for commercial attorneys to understand the necessary elements to establish a prima facie case for both actual and constructive fraud.

The material appearing in this website is for informational purposes only and is not legal advice. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. The information provided herein is intended only as general information which may or may not reflect the most current developments. Although these materials may be prepared by professionals, they should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

The opinions or viewpoints expressed herein do not necessarily reflect those of Lorman Education Services. All materials and content were prepared by persons and/or entities other than Lorman Education Services, and said other persons and/or entities are solely responsible for their content.

Any links to other websites are not intended to be referrals or endorsements of these sites. The links provided are maintained by the respective organizations, and they are solely responsible for the content of their own sites.