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When Adoption Agencies Close

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On December 16, 2016, the Department of State temporarily debarred the Hague accredited agency European Adoption Consultants (EAC), citing noncompliance with federal regulations. Less than two months later, on February 3, 2017, Independent Adoption Center (IAC), a large, multi-jurisdiction domestic adoption agency filed bankruptcy. The closures were met with surprise from fellow adoption professionals and panic and suspicion among waiting families. There has been much heartfelt coverage of the personal repercussions to families involved with those agencies. This article explores adoption agencies' financial obligations, the types of solutions available to insolvent agencies, possible repercussions, and best practices.

The goal of providing this information is two-fold: 1. To promote the notion that adoption professionals have both a mission-specific and a fiduciary responsibility to ensure the financial stability and survival of their agency, and 2. Help educate prospective adoptive families to evaluate the agency they choose to represent them, make informed decisions during the ongoing adoption process regarding finances, and what some of the options may be should they find themselves in the unfortunate circumstance that their adoption agency has closed.

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I. Regulating Insolvent Agencies

The Council on Accreditation (COA) sets forth requirements for bonding and insurance on international adoption service providers (ASPs),[1] as well as "sufficient cash reserves."[2] COA also requires that agencies provide refunds as appropriate and transfer files back to families or to other agencies when closing.[3] States often have similar requirements for the domestic adoption agencies they regulate.

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On its face, the consequence for noncompliance is suspension or revocation of accreditation, debarment, or losing the agency license, a moot point for insolvent agencies. However, as will be explained later, noncompliance could bolster a number of claims in court that the agency's directors and officers breached fiduciary duty and were negligent, or even committed fraud.

II. The Options: Informal Dissolution, Bankruptcy, Debarment

Organizations close in a variety of ways. Adoption agencies may informally dissolve (liquidate), although they are still subject to state and federal regulations that may impose notice and file transfer requirements. In an informal dissolution the professional fees for closing the organization are minimal, so this option is typically chosen by organizations that have no assets to fund professional fees to wind down the organization, let alone assets to distribute to creditors. Absent an investigation by authorities, families would depend on agencies to return their files.

Informal dissolutions are probably not practical for adoption agencies because adoption is so regulated. EAC seemingly attempted to informally dissolve after its debarment by the State Department, but the FBI and Ohio Attorney General's office received so many complaints from families that the Ohio AG has taken steps to formally dissolve EAC.

Agencies may formally dissolve in bankruptcy court, or even in state court under state insolvency proceedings. In a bankruptcy proceeding, an agency may attempt to restructure its debt under Chapter 11 so that it might survive the bankruptcy proceeding. Successful Chapter 11

[1] CFR 96.33(i).

[2] CFR 96.33(e)

[3] CFR 96.33(e)

resucturings are, however, lengthy, notoriously expensive[4], and usually unsuccessful.[5] The sensitivity of adoption makes it further unlikely that it would ever be a viable option for an adoption agency. Accordingly, discussion of bankruptcy in this article focuses solely on Chapter 7 liquidations.

Under Chapter 7 of the bankruptcy code, individuals and companies alike may have all of their debt "discharged" (i.e., forgiven or erased). Individuals emerge from the bankruptcy proceeding with a blank slate, while companies are liquidated as quickly as possible.

The benefit of formally liquidating an agency under bankruptcy is that the process is orderly and administered by a liquidation professional, the bankruptcy trustee. Creditors are prevented from taking action against the organization outside the bankruptcy court and must go through the trustee with all requests and concerns. This offers a benefit over informal dissolutions, where creditors may behave more aggressively in an attempt to secure the last remaining assets of a company and directors and officers of a company may have to personally fend off multiple lawsuits and investigations.

The bankruptcy trustee is responsible for complying with all relevant state and federal laws while liquidating the agency. In the IAC bankruptcy, the trustee coordinated with a number of state child welfare and adoption agencies to return files to families and provide post-adoption services.

Regulatory authorities, such as the Department of State and state governments, may forcibly debar adoption agencies. When that happens, the regulatory authority may revoke the license or accreditation of an agency, but it does not oversee the financial wind-down of the agency. Authorities may, however, seize property of the agency in the course of a criminal investigation, including family files. This is exactly what happened in the EAC debarment, where the Department of Justice seized files and families must rely on the Department of State to return the files.[6]

[4] "In my experience, attorney's fees run about 4% of annual revenue. If your company has $2,000,000 in revenue, expect to pay between $75,000 and $100,000 to your bankruptcy lawyer—and there may be expenses for accountants and other professionals on top of that." What You Need To Know About Chapter 11, Forbes https://www.forbes.com/2008/09/25/chapter-11-bankruptcy-ent-law-cx_rb_0925bovarnickchap11.html

[5] A frequent estimate holds that only about 25% of companies survive Chapter 11. See id.

[6] https://travel.state.gov/content/adoptionsabroad/en/about-us/newsroom/AdoptionNoticeUpdateonTransferofCasesafterEACDebarment.html

III. Who Gets Sued and How

a) Bankruptcy Court

When an organization files bankruptcy, it must be completely candid with the court about all aspects of the organization and be prepared for the lawyers and bankruptcy professionals to take control. In exchange for this openness and control, the court protects the debtor organization from creditors and even to some extent investigators, as the trustee will be the first person to assess whether financial crimes were committed. The bar for bankruptcy crimes is fairly high and includes acts such as knowingly concealing assets, perjury, bribery and embezzlement. The simple fact that an organization no longer has certain pre-paid funds does not by itself indicate fraud; debt is the nature of bankruptcy.

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The trustee fully liquidates the company, including any possible insurance claims, to fund her own professional fees and maximize any potential distribution to creditors. The bankruptcy trustee may initiate lawsuits to bring money into the bankruptcy estate. In the IAC bankruptcy, the trustee has sued the board of directors and executive officer in what is referred to as a Director and Officer or "D&O" lawsuit.[7] In a D&O lawsuit, the plaintiff, who is the bankruptcy trustee in this case, will try to prove that the board and executive officer of the agency "breached a fiduciary duty" to clients and were "negligent." Generally speaking, directors and officers who have maintained a clear separation between their personal assets and the agency's assets will be immune to personal liability in such lawsuits. Therefore, the trustee will try to collect money from IAC's insurance company, which provides D&O liability insurance.

The IAC trustee presented the court with detailed allegations of breach and negligence, alleging the directors and officers failed to:

- properly identify, monitor and account for liabilities
- ensure the on-going good name and reputation of the agency in the eyes of prospective birth mothers, adopting parents, and regulators
- take necessary action when the increasing differential between new contracts and availability of birth mothers became impossible to reverse

[7] Some believe there is expanding liability in bankruptcy court for directors and officers who do not sufficiently wind down operations before filing bankruptcy. This recent expansion of liability in bankruptcy law stems from statutes like the WARN Act, similar to state statutes regulating advance notice of adoption agency closures.

Punishing companies for not preparing for closing before bankruptcy or even giving notice would seem to depart from the bankruptcy code's tradition of incentivizing companies to make last ditch efforts to survive (i.e., rewarding the last creditors who invested and the loyal employees who stayed until the doors were shut, as well as penalizing aggressive creditors who push debtors into bankruptcy). Warning consumers of financial difficulty will cause a "run" on the agency, as everyone rushes to grab the last cash reserves of a struggling company. In that situation, the struggling company that may have otherwise had a chance to recover will certainly be forced into bankruptcy.

- take action to refund advances paid by adopting parents when it was clear the agency would not continue to fulfill obligations to adopting parents
- recognize and take action when it was clear that the agency's status quo would not reverse
- find options for fulfilling the agency's obligations under contracts with adopting parents
- cut overhead expenses
- perceive the financial significance of the downturn in new contracts
- use agency assets to make refunds to adopting parents or locate other services to fulfill obligations to adopting parents
- prepare for the orderly transition of files to government officials
- leave sufficient assets for government officials to take over the role that should have been served by the agency
- attempt to restructure rather than liquidate the agency
- timely acknowledge that the agency was facing a financial crisis
- call and conduct board and management meetings for the purpose of identifying the financial crisis and taking action to solve the crisis
- document with minutes, notes, and emails, the efforts made to resolve the agency's financial crisis
- identify and fulfill the agency's outstanding obligations to hundreds of adopting parents
- quantify in financial statements, internal reports, or otherwise, the true measure of outstanding obligations that the agency owed to adopting parents and other creditors
- properly plan and budget for future operations in light of the agency's financial circumstances
- properly transition to a new executive director to oversee the agency
- coordinate the closure of the agency with government officials that regulated the agency's operations
- take action in response to the losses reported in the audited financial statements
- adequately respond to complaints from adopting parents
- provide earlier notice to adopting parents that the agency would not fulfill its obligations
- take steps to ensure the on-going viability of the agency

- take steps to minimize the financial and emotional hardship to adopting parents
- comply with bylaws to make board members accountable to the community for adequate services to adopting parents
- comply with bylaws to exercise trusteeship of property and investments

These claims have not been proven, as the litigation is still pending. The list is included for instructive purposes only, to demonstrate the liability and expectations that may be placed on adoption agencies. If the trustee prevails and recovers insurance proceeds, the proceeds will be distributed according to the bankruptcy code's priority scheme. First in line are bankruptcy professionals, such as the trustee herself, her staff and hired professionals, and the agency's attorney. Secured creditors and certain priority creditors follow, and last in line are waiting families, who are the "general unsecured creditors." In most bankruptcy liquidations the general unsecured class gets only a few pennies on the dollar, if that.

b) Civil Court

When an organization closes informally and leaves many unpaid creditors, it can count on creditors filing lawsuits in civil court and complaints with authorities. Traditionally consumer creditors have had to initiate and fund their own lawsuits, but the government offers more consumer protections than in the past and may pursue debtor companies on behalf of creditors. This is what has happened in the EAC bankruptcy.

On June 1, 2017, the Ohio Attorney General filed a civil lawsuit against both EAC and the owner/director of EAC, alleging unfair and deceptive consumer sales practices, unconscionable sales practices, failure to deliver, breach of fiduciary duty, deceptive acts or practices and misleading the public, fraud, nuisance, and reformation of charitable trust.[8] The Ohio prosecutor is seeking financial penalties, refunds, dissolution of EAC, and to permanently bar the owner from forming any other Ohio nonprofits.

Sometimes creditors will try to "pierce the corporate veil" and sue owners of the organization, alleging that the organizational and personal assets were "co-mingled" to such an extent that the distinction between the corporation and the person is meaningless. The creditor also has to establish some sort of bad acts or fraudulent intent and it is not easy for plaintiffs to win this type of lawsuit. Regardless, the owner is stuck having to defend an expensive lawsuit. This is another reason that bankruptcy court may be the preferable option for dissolution, as these types of lawsuits are often prevented or consolidated in bankruptcy court.

[8] http://www.cleveland.com/court-justice/index.ssf/2017/06/ohio_attorney_generals_office.html

A bankruptcy trustee will not pursue this type of lawsuit unless the legal merits are strong and the target has money. An aggrieved creditor, on the other hand, tends to take matters much more personally and may pursue someone in court for revenge.

c) Criminal Court

The impetus for closing an agency may be finances, accreditation/licensing problems, or a criminal case. In the case of EAC, the criminal investigation seems to have been driven by consumer complaints about the insolvent agency. I cannot help but wonder how a bankruptcy filing might have changed the course of EAC's legal woes. The bankruptcy court, while not a shield against prosecution, might have offered the parties a "cooling off" period while forensic accountants objectively reviewed records.

In other instances, a criminal case may cause an agency to close. In 2014, employees of International Adoption Guides (IAG) were indicted for "conspiring to defraud the United States" with fraudulent adoption contracts and decrees, counterfeiting USCIS forms and bribing foreign officials. IAG's executive director plead guilty to a lesser offense of making false statements to COA during the accreditation process. In exchange for the plea, the government agreed to withdraw the pending indictment against the executive director. A sentencing hearing is scheduled in August of this year.

IV. Best Practices

Any field, but especially adoption, which touches lives so personally, is built on trust. In adoption, agencies can demonstrate fiscal responsibility to potential clients by asking for fees in a conservative and transparent manner. Detailed fee schedules create transparency and show that fees are required at the same time as services. When fees are exchanged for services that will be immediately provided, no debt is created and waiting families can be reasonably assured that if the client-agency relationship ends before the family has adopted, the family will have received value for each service they paid for and may be able to transition to the services of another agency or attorney.

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If an agency requires the prepayment of fees for services that will not be provided until some time in the future, the next best accounting practice would be to escrow or set aside those pre-paid funds.

For transparency, some agencies share agency-compiled data with waiting families that tells a story of the agency's strengths and weaknesses and helps set families' expectations of the agency. For example, evolving wait

times tell a story of not only trends in the field or changing government policies, but also how many waiting families the agency is contracting with.[9] A sharp increase in wait times may indicate that an agency is over-extended in terms of waiting families or has encountered obstacles in a country program.

Finally, every owner, as well as officers and board members, should evaluate their personal assets and create strategies to protect themselves and their families, such as best accounting practices, retirement accounts, homestead exemptions and trusts. Such planning should be undertaken early on in any endeavor. No one ever believes they will be sued until it happens and rare is the defendant who feels that he or she deserves it.

V. Preparation

If your agency is having serious financial difficulty and closing is one of the options you are considering, please consider consulting with an experienced insolvency attorney sooner rather than later. The right attorney should have extensive experience representing companies in insolvency proceedings, not just individuals. The attorney will explore solutions other than dissolution as well as the consequences of dissolving the agency and will advise you of best practices in planning for a bankruptcy or solutions for working out some of your debt. Most bankruptcy attorneys will not be familiar with regulations that require advance notice of adoption agency dissolution, so it is important to bring that issue to the attorney's attention.

VI. Conclusion

In every profession, every day, there are organizations that fail and those that carry on. There is nothing that can fully immunize against failure. Regulators hold agencies to standards that are extremely high, and rightly so. The best way to be continuously able to serve the children and families you exist for is to be extremely conscientious: engage in transparent financial practices and quality services, and share openly about program timelines and capacities with prospective adoptive parents. Further, when you can do so without putting detrimental consequences to the families already working with you, it is valuable to serve families who are caught up in the closing of agencies and to take into account the hardships they have faced. First and foremost, it serves the mission of finding a family

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[9] The bankruptcy trustee describes the cause of the IAC bankruptcy as follows: "In or about 2016, a confluence of events caused the Debtor to face a financial crisis, which events included difficulty in locating birth mothers, delays in finding birth mothers, a decrease in 'new signings' of adopting parents, and escalating overhead costs." *Memorandum of Points and Authorities in Opposition to Defendant Navigators Insurance Company's Motion to Dismiss*, Case No. 17-40327, U.S. Bankruptcy Court in the Northern District of California.

for every child that most agencies agree upon. Next it helps minimize negative outcomes in adoption profession-wide. Lastly, it can help shift negative perceptions of the adoption profession—showing that when hard things happen, there remain many quality agencies to serve the critical needs of children and families in difficult circumstances.

ABOUT THE AUTHOR

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Prior to joining Adoption STAR, Katie represented the State of Florida's Department of Children and Families as a senior prosecutor in Miami, where she prosecuted child abuse, abandonment and neglect cases. Katie also brings a strong background as an experienced federal litigator in complex commercial and bankruptcy disputes.

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