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WEALTH PLANNING GROUP AND PRACTICE MANAGEMENT GROUP: THE ETHICS OF ASSET PROTECTION PLANNING - AN OXYMORON?

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The Ethics of Asset Protection Planning
An Oxymoron?

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TABLE OF CONTENTS

Page

I. Ethical Considerations and the Estate Planner's Obligation[1]

A. Threshold Considerations

Each of the 50 states and the District of Columbia regulates the conduct of attorneys by a written code of professional ethics, the violation of which may subject an attorney to professional discipline.[51] Although these codes transcend any particular area of practice, certain aspects of asset protection planning are sometimes suggested as raising heightened ethics concerns. This is because, under certain circumstances, the goal of placing assets beyond the reach of creditors implicates the possibility that the attorney has assisted a "fraudulent conveyance" [52] and creditors' rights counsel and other detractors often argue that assisting in a "fraudulent conveyance" is an unethical act. Under most circumstances, of course, asset protection planning is as ethically innocuous as any other type of estate or business planning; for example, few would argue that it is unethical for an attorney to advise clients to organize a real estate holding company as a limited liability company rather than as a general partnership. Under questionable circumstances, however, an attorney is always well advised to first determine whether, under the governing code of professional ethics, the attorney is, in fact, permitted to act before counseling or otherwise assisting the client and in this regard asset protection planning is no different from any other area of practice.[53]

[51]Georgia, Iowa, Maine, Nebraska, New York, Ohio, Oregon, Tennessee, Vermont and Virginia currently follow the American Bar Association's *Model Code of Professional Responsibility*, promulgated in 1980. California and Florida have enacted substantially modified versions of the American Bar Association's more recent *Model Rules of Professional Conduct*, promulgated in 1983. *See* California's *Rules of Professional Conduct*; Florida's *Rules Regulating the Florida Bar*. The District of Columbia and all of the remaining states have enacted the *Model Rules of Professional Conduct* in substantially its original form.

[52]Black's Law Dictionary defines a fraudulent conveyance, in part, as "[a] transfer of property for little or no consideration, made for the purpose of hindering or delaying a creditor by putting the property beyond the creditor's reach." *Black's Law Dictionary* 672 (7th ed. 1999). The law of fraudulent conveyances is explored in depth in II, below.

[53]It is interesting to note, however, that from the client's perspective it likely would not matter whether the transfer of assets effectuates a fraudulent conveyance since, absent the odd statute imposing criminal liability for the fraudulent conveyance of property, the creditor's sole remedy is transferee liability (which in itself may be a practical nullity if the asset protection planning is effective). The potential for criminal liability for effecting a fraudulent conveyance is explored in depth in I, D, 3, b, below.

[1] The material herein is excerpted from Rosen and Rothschild, 810-2nd T.M., *Asset Protection Planning* and is reproduced with the permission of Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc., Washington, D.C.

Neither the American Bar Association's Model Code of Professional Responsibility nor the American Bar Association's Model Rules of Professional Conduct expressly speaks to asset protection planning, *per se*, and consequently, the suggestion that asset protection planning is impermissible is necessarily argued as being implicit under the governing rules. Specifically, each of the Model Code of Professional Responsibility and the Model Rules of Professional Conduct *arguably* precludes an attorney from advising or otherwise assisting a client in effectuating a fraudulent conveyance by reference to certain sections which bear upon arguably similar acts. For example, Model Code, DR 1-102, *Misconduct*, provides, in pertinent part, that "[a]lawyer shall not ... [e]ngage in conduct involving dishonesty, fraud, deceit, or misrepresentation" [54] nor should a lawyer "[e]ngage in conduct that is prejudicial to the administration of justice." [55] A corollary to the foregoing prohibitions is Model Code, DR 7-102, *Representing a Client Within the Bounds of the Law*, which provides, in pertinent part, that "[a] lawyer shall not ... [f]ile a suit, assert a position, conduct a defense, delay a trial, or take other action on behalf of his or her client when he knows or when it is obvious that such action would serve merely to harass or maliciously injure another" [56] nor should a lawyer "[c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent." [57]

[54] Model Code of Professional Responsibility DR 1-102(A)(4) (1980); see *In re Hockett*, 734 P.2d 877, 883 (Or. 1987) ("Assisting clients to cheat creditors is `dishonesty' under DR 1-102(A)(4). We conclude that the accused's act of assisting his clients in `fraudulent' transfers ... was done with the intent to cheat creditors of their lawful debts. Such conduct is `conduct involving dishonesty,' a violation of DR 1-102(A)(4)").

[55] Model Code of Professional Responsibility DR 1-102(A)(5) (1980).

[56] Model Code of Professional Responsibility DR 7-102(A)(1) (1980).

[57] Model Code of Professional Responsibility DR 7-102(A)(7) (1980).

Although the Model Code does not define what is meant by the term "fraud," at least one Model Code jurisdiction, New York, has provided that the term "does not include conduct, although characterized as fraudulent by statute or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another." [58] Therefore, in New York, and by extension in most if not all Model Code jurisdictions, the prohibition on an attorney counseling or assisting a client in perpetrating a "fraud" does not proscribe an attorney from counseling or assisting a client in transferring property because of the possibility that the client's transfer, in hindsight, may be determined to have been a "fraudulent conveyance."

[58] New York Code of Professional Responsibility, Definition 9 (1990).

Similar to the Model Code, the American Bar Association's 1983 Model Rules of Professional Conduct have also been incorrectly cited as prohibiting an attorney from advising or otherwise assisting a client in effectuating a fraudulent conveyance, *per se*. In this regard, Model Rule 1.2, *Scope of Representation*, provides in pertinent part that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent" [59] and Model Rule 8.4, *Misconduct*, provides, in pertinent part, that it is professional misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit or misrepresentation." [60] Significantly, however, under the terminology section of the Model Rules, the terms "fraud" and "fraudulent" are defined as "conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information" which are, therefore, clearly not inclusive of a fraudulent conveyance standing alone.[61] Finally, Model Rule 4.4, *Respect for Rights of Third Persons*, provides, in pertinent part, that "a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person." [62]

[59]Model Rules of Professional Conduct Rule 1.2(d) (1983).

[60]Model Rules of Professional Conduct Rule 8.4(c) (1983.

[61]Model Rules of Professional Conduct Terminology (1983); *see also In re Hockett*, 734 P.2d 877 (Or. 1987).

[62]Model Rules of Professional Conduct Rule 4.4 (1983).

Moreover, only a very few state and local bar ethics opinions have yet attempted to apply these rules to the transfer of property in furtherance of an asset protection plan.[63] One of those opinions is *Connecticut Informal Opinion 91-23*,[64] in which an attorney requested the opinion of the Connecticut Bar Association's Committee on Professional Ethics as to whether the attorney could ethically recommend and/or assist the attorney's client in transferring the client's jointly owned home to the client's wife at a time when the client had substantial debts beyond the client's ability to repay. Basing its opinion on Model Rules 1.2(d) and 4.4, and in certain limited circumstances, Model Rule 8.4(c), the Committee opined that "a lawyer may not counsel or assist a client to engage in a fraudulent transfer that the lawyer knows is either intended to deceive creditors or that has no substantial purpose other than to delay or burden creditors." [65] Significantly, however, the Committee further stated that:

> Although the inquirer invites us to focus on fraudulent transfers, we wish to point out that whether or not a particular transaction is a fraudulent transfer as a matter of substantive law is not the decisive factor in applying the Rules. The decisive factors are whether the lawyer knows that the transfer constitutes conduct having a purpose to deceive (see Rule 1.2(d)) or whether in counseling or assisting the client the lawyer is using means that have no substantial purpose other than to embarrass, delay or burden third parties (see Rule 4.4).[66]

[63]It should be noted that although the conclusions of state (or local) bar ethics committees are not binding authority in a subsequent disciplinary proceeding, their determinations are often both instructive to an attorney contemplating questionably objectionable conduct and persuasive to a disciplinary panel or court adjudicating the propriety of such conduct *ex post facto*.

[64]Connecticut Bar Association *Informal Opinion 91-22* (December 5, 1991).

[65]*Id.* at 1.

[66] *Id.* at 2.

According to the Committee, "... while all fraudulent transfers are generally thought of as illegal and can be set aside, the Rules do not apply to all illegal conduct but rather to conduct that is known to be criminal or fraudulent." [67] Therefore, *Connecticut Informal Opinion 91-23* suggests that for an attorney advising or otherwise assisting a client in asset protection planning to be acting unethically under the Model Rules the attorney must also be in violation of Model Rule 1.2(d) by knowing that such transfer constitutes conduct having a purpose to deceive, or Model Rule 4.4 by using means that have no substantial purpose other than to embarrass, delay or burden third parties.[68] In contrast, since the Model Code prohibits an attorney from counseling or assisting a client in conduct which is simply illegal, though not necessarily criminal,[69] *Connecticut Informal Opinion 91-23* suggests that *knowingly* giving advice or otherwise assisting a client in effectuating a fraudulent conveyance would, in and of itself, constitute a violation of the Model Code.[70]

[67] *Id.* Notwithstanding the opinion of the Connecticut Bar Association, however, whether all fraudulent transfers are generally thought of as illegal is clearly subject to dispute. *See, e.g.*, *Mack v. Newton*, 737 F.2d 1343, 1361 (5th Cir. 1984), ("Nowhere does [the Texas fraudulent conveyance statute] purport to prohibit any transfers to render the making or receiving of them illegal or wrongful."); *Accord*, *Elliott v. Glushon*, 390 F.2d 514, 516 (9th Cir. 1967), stating that in a fraudulent transfer, "[t]he actions legislated against are not `prohibited,' those persons whose actions are rendered `null and void' are not made `liable'; and terms such as `damages' are not used. The legislative theory is cancellation, not the creation of liability for the consequences of a wrongful act."

[68] See also *Florida Bar v. Rood*, 622 So.2d 974, 977 (Fla. 1993) (attorney suspended for one year for violating Florida Rule 4-8.4(c) (a lawyer shall not engage in conduct involving dishonesty, fraud, deceit, or misrepresentation) and Rule 4-8.4(d) (a lawyer shall not engage in conduct that is prejudicial to the administration of justice), *inter alia*, where the attorney assisted the attorney's son in fraudulent conveyance of property to attorney and the attorney knew of existence of judgment against the attorney's son).

[69] Model Code of Professional Responsibility DR 7-102(A)(7) (1980).

[70] *Accord*, *In re Hockett,* 734 P.2d 877 (Or. 1987) ("Advising and assisting clients to engage in conduct forbidden by statute violates DR 7-102(A)(7). We find that the accused knowingly engaged in assisting his clients in conduct "that the lawyer knew to be illegal" under DR 7-102(A)(7)."). This important distinction between the proscriptions of the Model Code of Professional Responsibility and those of the Model Rules of Professional Conduct is well summarized in Charles W. Wolfram's work, *Modern Legal Ethics*: "the focus has been upon client conduct that is criminal, fraudulent, or contrary to a direct ruling of a court. Are the considerations different if the client's conduct is not of this description but violates other law? For example, what if the client wishes to pursue a course of conduct that is unconscionable under applicable law but is not criminal, fraudulent, or in violation of a court order? What of client conduct that violates the law of torts, contracts, property, or some other noncriminal law that does not deal with fraud? The answer to those questions is ambiguous under the Code. Under the Model Rules a lawyer who assists the conduct described definitely commits no professional offense." Wolfram, *Modern Legal Ethics*, 706, §13.3.9 (West Publishing, 1986).

Whether a particular fraudulent transfer constitutes conduct having a purpose to deceive within the meaning of Rule 1.2(d) seems a simple enough question of fact.

A more significant question is whether a particular fraudulent transfer has a substantial purpose other than to delay or burden third parties within the meaning of Rule 4.4. In this regard the Committee stated that:

> Fraudulent transfers delay and burden those creditors who would be inclined to try and satisfy their unpaid debts from property of the debtor. It forces them to choose either not to challenge the transfer and suffer the loss of an uncollected debt or to file an action to set aside the transfer with the attendant costs in terms of time and money. If there is no other substantial purpose, Rule 4.4 applies. Where there is another substantial purpose, Rule 4.4 does not apply. For example, where there is a demonstrable and lawful estate planning purpose to the transfer Rule 4.4 would not, in our view apply.[71]

[71] Connecticut Bar Association *Informal Opinion 91-22* at 7. *See also* the Oregon Supreme Court's opinion in the matter of *In re Hockett*, 734 P.2d 877 at 883 (Or. 1987) ("we cannot say that the accused's conduct in his handling of the [marital] dissolution cases [which were found to have involved fraudulent conveyances] 'serve[d] merely to harass or maliciously injure' the creditors. His conduct did harass and injure the creditors, but that was not his sole aim.").

In *Ethics Opinion 1993-1 of the Legal Ethics and Unlawful Practice Committee of the San Diego County Bar Association*,[72] the Committee considered the extent to which a member of the State Bar of California could ethically advise or otherwise assist a client in avoiding *existing and identifiable* creditors' rights and protecting the client's assets. The Committee held that an attorney could not furnish advice or institute asset protection techniques unless the attorney did so in compliance with California State Bar Rules of Professional Conduct, *Advising the Violation of Law*, Rule 3-210 which provides that "[a] member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid." Moreover, since California has criminalized the act of causing a fraudulent conveyance,[73] the Committee held that it would be a violation of the California State Bar Rules of Professional Conduct for the attorney to furnish advice or institute asset protection techniques where, as here, the client had *existing and identifiable* creditors.[74] Beyond the effect of California's generally unique criminal statute, however, the Committee also noted that under the Rules of Professional Conduct of the State Bar of California, Rule 1-100, *Rules of Professional Conduct, In General*, "an Attorney does maintain a duty to protect the public and to promote respect and confidence in the legal profession. At a minimum, the Attorney's assistance with, and facilitation of the Client's expressed, wrongful intent is intolerable as a matter of public policy." [75] It is important to note, however, that the facts upon which the Committee opined involved *existing and identifiable* creditors; where there are no existing and identifiable creditors, and the client's expressed intent is not wrongful, there is no stated prohibition against asset protection planning in California, or elsewhere.

[72] Summarized in ABA/BNA Lawyer's Manual on Professional Conduct, 1001:1801, American Bar Association and The Bureau of National Affairs, Inc. (1991-1995).

[73] Cal. Penal Code §531 (West 2002) ("Every person who is a party to any conveyance of any lands, tenements, or hereditaments, goods or chattels, or any right or interest issuing out of the same, or to any bond, suit, judgment, or execution, contract or conveyance, had, made or contrived with intent to deceive and defraud others of their just debts, damages or demands; or who, being a party as aforesaid, at any time wittingly and willingly puts in, uses, avows, maintains, justifies, or defends the same, or any of them, as true, and done, had, or made in good faith, or upon good consideration, or aliens, assigns, or sells any of the lands, tenements, hereditaments, goods, chattels, or other things before mentioned, to him or them conveyed as aforesaid, or any part thereof, is guilty of a misdemeanor."). *See also Allen v. State Bar*, 20 Cal.3d 172, 178, 570 P.2d 1226, 1229, 141 Cal. Rptr. 808 (1977) ("Participating in a scheme to defraud creditors is a crime (Pen. Code §531) and properly subjects an attorney to disciplinary action").

[74] *See also Townsend v. State Bar of California*, 32 Cal.2d 592, 197 P.2d 326 (1948) (attorney suspension for three years for transferring client's real property after learning of decision adverse to client since transfers were found to have been for the purpose of hindering, delaying and defrauding client's creditor and preventing recovery upon judgment).

[75] Rules of Professional Conduct of the State Bar of California, Rule 1-100(A) (1988).

Distinguishable from the proposed avoidance of existing and identifiable creditors' rights in each of Connecticut Informal Opinion 91-23 and Ethics Opinion 1993-1 of the Legal Ethics and Unlawful Practice Committee of the San Diego County Bar Association, is a 1984 opinion of the South Carolina Bar Ethics Advisory Committee which specifically held that it was ethical for an attorney to transfer a client's assets to protect against the potential claims of future creditors.[76] Specifically at issue was whether the Model Code (which governed professional ethics in South Carolina at the time of the opinion) prohibited an attorney from transferring a client's property from the client's name to the name of the client's spouse in anticipation of the possibility of a judgment being entered against the client. Although the Committee held that such conduct for the sole purpose of avoiding an immediate reasonable probability of judgment would be in violation of DR 7-102(A)(7), it noted that:

> The critical issue would be whether or not the transfer took place with a reasonable prospect that a judgment would be obtained against the client, or whether or not the transfer took place to avoid some possibility in the distant future...If...there does not exist the immediate reasonable prospect of a judgment being entered against the client, the transfer merely to avoid the future possibility of an action by a creditor or creditors would not be in violation of DR 7-102(A)(7).[77]

[76] South Carolina Bar Ethics Advisory Opinion 84-02.

[77] *Id.* This position is consistent with the general rule that an owner of property has an almost absolute right to dispose of such property in any manner that the owner might see fit, restricted only by the fact that such transfer cannot be made to the injury or prejudice of certain (but by no means all) *existing* creditors. *See* the United States Supreme Court's decision in *Grupo Mexicano de Desarollo, S.A. v. Alliance Bond Fund, Inc.* 527 U.S. 308, 319 (1999), wherein the Court, in determining that the District Courts of the United States do not have the equitable power to grant pre-judgment attachment to a creditor, stated that "[t]he rule requiring a judgment [before attachment would be allowed] was a

product, not just of the procedural requirements that remedies at law had to be exhausted before equitable remedies could be pursued, but also of the substantive rule that a general creditor (one without a judgment) had no cognizable interest, either at law or in equity, in the property of his debtor, and therefore, could not interfere with the debtor's use of that property."). *See also Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 94 N.Y.2d 541, 729 N.E.2d 683, 708 N.Y.S.2d 26 (N.Y. 2000);*Jacksonville Bulls Football, Ltd. v. Blatt*, 535 So.2d 626 (Fla. App. 3d Dist. 1988); *Van Royen v. Lacey*, 262 Md. 94, 101 (Md. Ct. of App. 1970) ("until the time that the appellant secured her judgment against Lacey, he was free to do with his share of the property what he would.").

In an implicit acknowledgment that asset protection planning is not unethical except where it also occasions a fraudulent conveyance, the State Bar of California Committee on Professional Responsibility and Conduct has declined to rule on two requests for ethics opinion involving questions similar to the one at issue in *Ethics Opinion 1993-1*, stating in one instance that "the committee again determined not to issue an opinion as [it] continue[s] to believe that this matter is primarily a legal matter rather than an ethics matter." [78]

[78]Ethics Opinion No. 92-0005 (formerly 91-0004).

Finally, in contrast to the foregoing ethics opinion which clearly distinguish between existing creditors and remote or unknowable future creditors, some creditors' rights advocates nevertheless posit that since the Uniform Fraudulent Transfer Act provides that a transfer is fraudulent even if the creditor's claim arose after the transfer was made if it was made with an *actual* intent to hinder, delay, or defraud, asset protection planning is, by its very definition, *per se* unethical since it involves, at least in part, an actual intent to place assets beyond the reach of potential future creditors.[79] Based upon a number of fraudulent transfer cases set out in II, below, however, the hallmark of actual intent requires the courts to distinguish between those future creditors which are existing and identifiable at the time a transfer is made and those future creditors which are unknowable and that as to this latter group, no actual intent can exist.[80] Moreover, it is seemingly impossible to reconcile the extreme position that asset protection planning is *per se* unethical with the United States Supreme Court's decision in *Grupo Mexicano de Desarollo, S.A. v. Alliance Bond Fund, Inc.,* and the decision of the New York State Court of Appeals in *Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, each of which concluded that a pre-judgment creditor does not have any right to interfere with the debtor's free transfer of assets.[81] Finally, it is worth reiterating that even where a fraudulent conveyance does exist, as per *Connecticut Informal Opinion 91-23* it does not necessarily follow in a Model Rules jurisdiction that the attorney's conduct in effectuating the conveyance was unethical; though circumspection may, nevertheless, be warranted.

[79]*See* Uniform Fraudulent Transfer Act §4(a)(1) (1984). The United States Bankruptcy Code similarly provides that a Bankruptcy Court will set aside any transfer made with the "actual intent to hinder, delay or defraud" a creditor. *See* 11 USC §548(a)(1).

[80]*See*, *e.g.*, *First Nat'l Bank in Kearney v. Bunn*, 195 Neb. 829, 241 N.W.2d 127 (Neb. S.Ct. 1976); *Hurlbert v. Shackleton*, 560 So.2d 1276 (Fla. App. 1st Dist. 1990); *In*

the Matter of Joseph Heller Inter Vivos Trust, 161 Misc.2d 369, 613 N.Y.S.2d 809 (Surr. Ct. 1994).

[81] *Grupo Mexicano de Desarollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999); *Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 94 N.Y.2d 541, 729 N.E.2d 683, 708 N.Y.S.2d 26 (N.Y. 2000).

B. Obligation to Client

The United States Supreme Court has stated that "[t]he duty of the lawyer, subject to his role as an `officer of the court,' is to further the interests of his clients by all lawful means, even when those interests are in conflict with the interests of the United States or of a State. But this representation involves no conflict of interest in the invidious sense. Rather, it casts the lawyer in his honored and traditional role as an authorized but independent agent acting to vindicate the legal rights of a client, whoever it may be." [82] Similarly, Model Code, DR 7-101, *Representing a Client Zealously*, provides in pertinent part that "[a] lawyer shall not intentionally fail to seek the lawful objectives of his client through reasonably available means permitted by law and the Disciplinary Rules, except as provided by DR 7-101(B)." [83] Interestingly, The Model Rules of Professional Conduct contain no comparable provision; closest is Comment [1] to Rule 1.3, *Diligence*, which provides in part that "[a] lawyer shall act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf." [84]

[82] *In re Griffiths*, 413 U.S. 717, 724 (1973).

[83] Model Code of Professional Responsibility DR 7-101(A)(1) (1980). DR 7-101(B) provides in pertinent part that "[i]n his representation of a client, a lawyer may ... [r]efuse to aid or participate in conduct that he believes to be unlawful, even though there is some support for an argument that the conduct is legal." Model Code of Professional Responsibility DR 7-101(B)(2) (1980).

[84] Model Rules of Professional Conduct Rule 1.3, Comment [1] (1983).

In consequence of the foregoing, it can be safely stated that there exists no requirement that an attorney assert the potential rights of his or her client's adversary; instead the client's adversary is left to vindicate his or her own rights, if possible. In fact, it is clear that in certain circumstances an attorney may be subject to discipline for failing to promote his or her client's lawful asset protection plan with sufficient zeal and vigor, not to mention a potentially significant malpractice exposure to the attorney for such neglect; although such an action would, at this juncture, admittedly be a matter of first impression in every jurisdiction.[85]

[85] For example, in the case of *In re Hockett*, 734 P.2d 877 (Or. 1987), the Oregon Supreme Court, contrasting the attorney/defendant's duty to maximize the wives' matrimonial awards from the attorney/defendant's conflicting duty to their husbands, stated that "[a]s the lawyer for Mr. Beecroft and Mr. Neptune, the accused's obligation was to protect them from the claims of creditors, to the fullest permissible extent."

C. Potential for Attorney Liability

An attorney's potential exposure to professional discipline for having advised or otherwise assisted a client in asset protection planning must be distinguished from the attorney's potential exposure to his or her client's creditors for having rendered such advice or assistance. In this regard, it is important to note that even though an attorney may be found guilty of having violated an ethical rule, such finding will not necessarily give rise to a cause of action under either the Model Rules of Professional Conduct [86] or the Model Code of Professional Conduct.[87] Neither does the violation of an ethical rule create a presumption that a legal duty has been breached.[88] This is not to say, however, that some overlap does not exist; clearly the same conduct, if in fact wrongful, may form the basis for both the attorney's ethical breach and the attorney's potential liability to his or her client.[89] Differing considerations and policy concerns do, however, apply in determining whether the attorney has acted beyond the pale in each such regard, which in turn necessitate a separate analysis for each such potential liability.

[86] According to the "Scope" section of the Model Rules of Professional Conduct, "[v]iolation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed as a basis for civil liability"; *see also Wiseman v. Bathcelor*, 864 S.W.2d 248 (Ark. 1993).

[87] According to the Preliminary Statement to the Model Code of Professional Responsibility, "[t]he Code ... [does not] undertake to define standards for civil liability of lawyers for professional conduct"; *see Lazy Seven Coal Sales, Inc. v. Stone & Hinds*, 813 S.W.2d 400, 404 (Tenn. 1991) ("It is clear that the purpose of the Code is to state when a lawyer will be subject to disciplinary action and not to define standards whereby he may be held civilly liable.").

[88] Model Rules of Professional Conduct, *Scope*.

[89] *See e.g.*, *Fishman v. Brooks*, 487 N.E.2d 1372 (Mass. 1986) (ethics violation under Model Code properly admitted as relevant evidence that lawyer's conduct is below the appropriate standard of care).

1. Civil Liability

It has long been recognized that "[t]he action of an attorney in a lawsuit frequently angers his client's opponent because the attorney by his energy often must advance his client's cause at the expense of the opponent. It is not infrequent that persons who have lost a lawsuit because of actions undertaken by an attorney on behalf of his client, feel that they have been unjustly dealt with by the attorney. Such results are one of the unfortunate byproducts of the adversary system before the courts." [90] Arguably, an attorney's exposure to suit is heightened in the asset protecting planning context since by its very nature, effective asset protection planning serves to frustrate an adversary's enforcement of a judgment, which, in effect, has already vindicated his legal position *vis a vis* the defendant.

[90] *Pickard v. Maritime Holding Corp.*, 161 So. 2d 239, 241 (Fla. App. 3d Dist. 1964).

In general, however, an attorney acting under employment, at the direction of his or her client and in a legal manner is not liable for the consequences of his or her client's actions.[91] "A lawyer is authorized to practice his profession, to advise his clients, and to interpose any defense or supposed defense without making himself liable for damages." [92]

[91]*Id.* at 241.

[92]*Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1080 (2d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); *See also Brown v. LaChance*, 477 N.W.2d 296, 301 (Wis. Ct. App. 1991) ("If an attorney must be responsible not only to his or her own client but also to a third party nonclient, a potential conflict of interest may be inevitable, thus impairing an attorney's ethical obligations to represent his or her own client within the bounds of the law.").

The innoculation of an attorney acting in furtherance of the profession is not, however, unlimited. For example, one court has stated that:

> the privilege an attorney has for his actions in representing a client is a qualified one that does not extend to the intentional torts of malicious prosecution and abuse of process. Nor should the privilege apply to the intentional acts of furthering and participating in a fraudulent conveyance.[93]

[93]*McElhanon v. Hing*, 151 Ariz. 386, 728 P.2d 256 (1986), *aff'd in part, rev'd in part* 151 Ariz. 403, 728 P.2d 273 (1986).

Whether an attorney has violated this standard, whether in the context of asset protection planning or elsewhere, is dependent upon the facts and circumstances of the matter.

a. Conspiracy

Where suit is brought against both the client and his or her attorney, a "civil conspiracy" is often alleged. A "civil conspiracy" is a combination by two or more persons to commit an unlawful act that causes damage to a person or property.[94] A list of the separate elements of civil conspiracy includes:

(1) an agreement between two or more persons;

(2) to participate in an unlawful act, or a lawful act in an unlawful manner;

(3) an injury caused by an unlawful overt act performed by one of the parties to the agreement;

(4) which overt act was done pursuant to and in furtherance of the common scheme.[95]

Unlike a criminal conspiracy, however, in a civil conspiracy the agreement itself is neither wrongful nor actionable. Instead, the action is one for damages arising out of the acts committed pursuant to the conspiracy.[96] The fact that an action for civil conspiracy requires damages arising out of the acts committed pursuant to the conspiracy has formed the nucleus for the general (although by no means unanimous) rule that there can be no liability to a *general* creditor pursuant to a conspiracy to effectuate a fraudulent conveyance.[97]

[94] *See Black's Law Dictionary* 305 (7th ed. 1999).

[95] *See*, *e.g.*, *Ryan v. Eli Lilly & Co.*, 514 F. Supp. 1004, 1012 (D. S.C. 1981).

[96] *Onderdonk v. Lamb*, 79 Wis.2d 241, 255 N.W.2d 507 (1977); *Tovrea Land & Cattle Co. v. Linsenmeyer*, 100 Ariz. 107, 412 P.2d 47 (1966). "It is only where means are employed, or purposes are accomplished, which are themselves tortious, that the conspirators who have not acted but have promoted the act will be held liable." Prosser, *Law of Torts* §46 at 293 (4th ed. 1971).

[97] Those states in which a general creditor can maintain an action for a conspiracy to commit a fraudulent conveyance are Alaska, Arizona, Arkansas, Idaho, Illinois, New Jersey, Ohio, Pennsylvania and Wisconsin. *See*, *e.g.*, *Celano v. Frederick*, 203 N.E.2d 774 (Ill. App. 1st Dist. 1964) (complaint charging attorneys with conspiring with judgment debtor to fraudulently deprive judgment creditor of money due in satisfaction of judgment stated a cause of action for conspiracy against defendant attorneys). Contrast, however, the potential for attorney liability to a client's creditors in Alaska, which has been specifically negated in certain instances. *See*, *e.g.*, Alaska Stat. §34.40.110(f), which does not permit a creditor or any other person from asserting a cause of action for conspiracy to commit a fraudulent conveyance or aiding and abetting a fraudulent conveyance against a person involved in the preparation or funding of an Alaska "asset protection" trust.

Application of this general rule is demonstrated by the United States Supreme Court in *Adler v. Fenton*.[98] In that case, the Court stated that:

[98] 65 U.S. 407 (1860).

> The plaintiff complained of the fraud of the defendant in purchasing the property of his absconding debtor, in order to aid and abet him in the fraudulent purpose of evading the payment of his debt. The court asks, what damage has the plaintiff sustained by the transfer of his debtor's property? He has lost no lien; for he had none .... The most that can be said is that he intended to attach the property, and the wrongful act of the defendant has prevented him from his intention .... In the absence of special legislation, we may safely affirm that a general creditor cannot bring an action on the case against his debtors, or against those combining and colluding with him to make dispositions of his property, although the object of those dispositions be to hinder, delay and defraud creditors.[99]

[99] *Id.* at 412-413. *See also Mack v. Newton*, 737 F.2d 1343 at 1356 (5th Cir. 1984) ("Nor do we find that the Trustee has any cause of action for civil conspiracy ... The

essence of a cause of action for conspiracy is damage resulting from the commission of a wrong which injures another, and not the conspiracy itself. The damage suffered by a general creditor when property is fraudulently conveyed to another to evade payment is the deprivation of an opportunity to make a levy on the property. This damage, however, is too remote to support recovery."); *Bartol v. Bennett*, 56 N.Y.S.2d 314, 315 (N.Y. County 1945) ("[I]n the absence of an existing *lien* on the property of the debtor, the creditor has no ground for complaint because of the acts charged, since until he acquires such a lien there has been no evasion by the defendants of any legal rights of the plaintiff-creditor").

Similarly, in the seminal New York case of *Federal Deposit Insurance Corp. v. Porco*,[100] the receiver of an insolvent bank obtained a $6,000,000 judgment against the director of the bank's parent corporation due to losses suffered by the bank as a result of the director's involvement in the bank's affairs. Thereafter, the receiver brought suit against two bank officials who had assisted the director in transferring monies in which the director was beneficially interested to an account in Switzerland. The receiver alleged that the bank officers were liable for having helped the director effectuate the transfer which fraudulently deprived the receiver of monies to which it was entitled. The receiver did not, however, allege that the bank officers were recipients of the funds nor that they benefited in any way from the transfer. The Court of Appeals held that a creditor's remedy for the transfer of its debtor's assets was to obtain nullification of the conveyance and that there is no creditor's remedy for money damages against parties who were neither transferees of the assets nor beneficiaries of the conveyance.[101]

[100] 75 N.Y.2d 840, 552 N.E.2d 158, 552 N.Y.S. 2d 910 (Ct. App. 1990).

[101] *See also Elgin Sweeper Co. v. Melson Inc.*, 884 F. Supp. 641 (N.D.N.Y. 1995); *Geren v. Quantum Chem. Corp.*, 832 F. Supp. 728 (S.D.N.Y. 1993); *Gallant v. Kanterman*, 198 A.D.2d 76 (N.Y. App. Div. 1st Dep't 1993); *But see Stochastic Decisions, Inc. v. DiDomenico*, 995 F.2d 1158 (2d Cir. 1993).

Other courts have negated potential liability pursuant to an alleged conspiracy to commit a fraudulent conveyance by holding that a fraudulent transfer is not, in the first instance, a tort.[102] Absent a tort, there can necessarily be no liability pursuant to an alleged civil conspiracy since, as previously noted, in a civil conspiracy it is not the agreement itself which is wrongful or actionable, but rather the action is one for damages arising out of the *tortious* acts committed pursuant to the conspiracy.

[102] *See FDIC v. S. Prawer & Co.*, 829 F. Supp. 453, 455 (D. Me. 1993) ("The Court is satisfied that violation of either Maine's Uniform Fraudulent Transfers Act or the Uniform Commercial Code's Bulk Sales Act is not a tort");*U.S. v. Franklin Nat'l Bank*, 376 F. Supp. 378 (S.D.N.Y. 1973) ("The New York Debtor and Creditor Law ... which adopts verbatim the Uniform Fraudulent Conveyance Act, does not confer upon the creditor a right of action in tort against the grantee").

In those states which do permit a creditor's remedy against co-conspirators to a fraudulent conveyance, recovery is generally limited to persons who are transferees of the assets and beneficiaries of the conveyance. Some cases do suggest, however, that a conspirator (whether or not an attorney) is not necessarily exonerated from liability because the conspirator may not have benefited from fraudulent conveyance.[103]
In general though, where the attorney's only connection to the fraudulent transfer is as the recipient of a portion of the client's transferred assets as a legal fee, the attorney will generally not be held liable; however, if the attorney receives more than payment of a past due fee, such additional consideration carries the potential of the attorney being found liable in civil conspiracy.

[103] *See e.g.*, *Dalton v. Meister*, 71 Wis.2d 504, 239 N.W.2d 9 (S.Ct. of Wis., 1976).

b. Aiding and Abetting

The prime distinction between liability for a civil conspiracy and liability for aiding-abetting is that a conspiracy involves an agreement to participate in a wrongful activity. By contrast, aiding-abetting focuses on whether a defendant knowingly gave "substantial assistance" to someone who performed wrongful conduct, not on whether the defendant agreed to join the wrongful conduct.[104] The elements of "aiding and abetting" liability are: (1) the party whom a defendant aids and abets must perform a wrongful act that causes injury; (2) the defendant must be generally aware of his or her role as part of an overall tortious activity at the time that he provides the assistance; and (3) the defendant must knowingly and substantially assist the principal violation.[105] However, as with civil conspiracy liability, due to an absence of damages there is substantial authority to the effect that a general creditor can not recover against a person based upon an alleged aiding and abetting of a fraudulent conveyance.[106] Again, similar to the civil conspiracy context, there is also substantial uncertainty as to whether a tort of aiding and abetting even exists.[107]

[104] *Halberstam v. Welch*, 705 F.2d 472 (D.C. Cir. 1983).

[105] *Id.*; *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980), *cert. denied*, 449 U.S. 919 (1980).

[106] *Adler v. Fenton*, 65 U.S. 407 (1860).

[107] *See, e.g.*, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, at 167 (1994) ("The doctrine [of civil liability for aiding and abetting a tort] has been at best uncertain...[T]he common law precedents are `largely confined to isolated acts of adolescents in rural society.' "); *Cenco Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir.), *cert. denied*, 459 U.S. 880 (1982) ("There is no tort of aiding and abetting under Illinois law, or, so far as we know, the law of any other state ... The only utility of a separate tort of aiding and abetting in the commission of a tort would be to give plaintiffs' lawyers one more charge to fling at the jury in the hope that if enough charges are made the jury may accept at least one ... We have much the same reaction to the conspiracy count, though the fact that Seidman does not argue that there is no tort of conspiracy makes us diffident about disposing of it on this ground."). *But see Joel v. Weber*, 602 N.Y.S.2d 383, 396-397 (App. Div. 1st Dept. 1993) ("Lacking merit is [the law firm's] contention that, as a law firm, it is immune from any `aider and abettor liability' for merely having provided legal advice to its client ... Although mere negligence by an attorney in rendering advice to a client does not support a separate right

of action by a third party allegedly injured by that advice, nevertheless, under New York law, an attorney may be liable to third parties for actions taken in furtherance of his role as counsel upon proof, as alleged in detail by the plaintiffs herein, of the existence of "fraud, collusion, malice or bad faith.").

c. Malpractice

Distinguishable from the foregoing analysis of the attorney's potential for incurring liability for advising or otherwise assisting a client in asset protection planning is the question of legal malpractice. Legal malpractice is distinguishable because it looks to the potential of the attorney being held liable to *his or her own client*, rather than to a professional disciplinary body or the client's adversaries. Traditionally, the absence of privity between an attorney and a non-client of the attorney has resulted in the general rule that an attorney may not be held liable for unintentional or merely negligent conduct, even if such conduct is the proximate cause of injury.[108] However, there is a trend in some disciplines, such as estate planning, to find privity between the attorney and certain third parties, such as a client's intended beneficiaries.

[108] *See* Wolfram, *Modern Legal Ethics* (West Publishing 1986).

In order for an attorney to be found liable for malpractice, it must be found that the attorney failed to exercise the care, skill and diligence that is commonly exercised by other attorneys practicing in similar situations. Moreover, an attorney who either purports to specialize in a discrete area of law, or who would be recognized by attorneys of ordinary prudence as practicing in an area of law which requires the skills and competence of a legal specialist, will normally be held to the higher standard of care to which legal specialists practicing in the same area would conform. Arguably, asset protection planning is such a specialized area of law and attorneys without the requisite heightened level of expertise should be chary of practicing in this field without the assistance of expert co-counsel.

2. Criminal Liability

As will be discussed more fully in II, below, England's Statute of Elizabeth of 1571 is the basis of fraudulent conveyance law throughout the common law world which includes, of course, the United States. Of significance, however, is the fact that although the Statute of Elizabeth provides that all parties to a fraudulent conveyance are guilty of a misdemeanor, the imposition of criminal liability for effectuating a fraudulent conveyance has generally not been followed in the United States and only an extremely small minority of states have chosen to follow the Statute of Elizabeth in this regard.[109] Several other states, as well as the Model Penal Code, however, have chosen to criminalize a fraudulent conveyance under specific circumstances, such as where the defendant knows that an administrator of the debtor's property has been or is about to be appointed.[110] Yet a few other states that have criminalized the fraudulent conveyance of property limit the application of the law to the transfer of secured or mortgaged property.[111]

[109]*See* Cal. Penal Code §531 (West 2002), Ill. Comp. Stat. ch. 720 §5/17-14 (2001). ("A person who is a party to a fraudulent conveyance of lands, tenements or hereditaments, goods or chattels, or a right or interest issuing out of the same, or to a bond, action, judgment, or enforcement thereof; contract or conveyance had, made, or contrived, with intent to deceive and defraud others, or to defeat, hinder, or delay creditors or others of their just debts, damages, or demands, or who is a party as stated in this section, at any time wittingly and willingly puts in use, avow, maintain, justify, or defend the same or any of them as true, and done, had, or made in good faith, or upon good consideration, or sells, aliens, or assigns any of the lands, tenements, hereditaments, goods, chattels, or other things mentioned in this section, to him or her conveyed as stated in this section, or any part thereof, is guilty of a business offense and shall be fined not exceeding $1,000.").

[110]*See e.g.*, Model Penal Code §224.11; N.Y. Penal Law §185.00.

[111]*See e.g.*, Md. Code Ann. art. 27, §214 (1999); Mass. Ann. Laws ch. 266, §80 (2000); N.Y. Penal Law §§185.05 and 185.10.

Finally, it should be noted that for federal purposes, it is a crime under the Bankruptcy Code when a person, "in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation."[112] If found guilty of such an offense, the defendant may be fined up to $5,000 or sentenced up to five years in jail, or both.[113] Although the use of the term "knowingly" in the foregoing provision seems to require specified knowledge or intent before criminal liability can be imposed, in actuality the legislative history indicates that the knowledge requirement can also be met by showing "willful blindness" (which suggests the need for attorneys and others engaged in asset protection planning to follow careful "due diligence" procedures).[114] Moreover, a person alleged to have perpetrated a fraud on a federal court is also potentially subject to being charged with "obstruction of justice" in violation of 18 USC §1503.

[112]18 USC §152.

[113]*Id.*

[114]See I, D, 4, c, below.

D. Risk Minimization

In light of the ethical constraints imposed upon counsel, as well as the potential for civil or even criminal liability under certain circumstances, an attorney practicing in the area of asset protection planning must be circumspect, first in accepting new clients and then in advising and servicing them. As a consequence, the asset protection attorney should be especially careful in performing due diligence with respect to a client's legal and credit status.

In order to minimize the potential risks associated with assisting a client whose circumstances do not allow many asset protection planning techniques to be employed, the asset protection planning attorney should, at a minimum, make sure to (i) follow established "know your client" procedures, (ii) conduct or obtain a solvency analysis of the client, and (iii) conduct a careful "due diligence" review with regard to the client's circumstances.

1. Know Your Client

In the first instance, the attorney should know his or her client, including: (i) the source of the client's wealth; (ii) the particulars of the client's business or employment; (iii) the client's reasons for seeking advice and/or assistance with regard to asset protection planning; (iv) whether the client has been referred by a reputable source, and finally; (v) whether the client has any current creditor issues or is merely insuring against as yet unknown, but nevertheless potentially problematic, future creditor risks. Based upon an analysis of the foregoing, the planner should ask whether, and to what extent, the client is an appropriate candidate for asset protection planning.[115]

[115] In the event that it later becomes necessary for the attorney to demonstrate that the attorney has been discriminate in accepting clients for asset protection planning, the attorney may wish to maintain a file regarding those individuals seeking asset protection assistance which the attorney has chosen to turn away and the reasoning behind those decisions.

2. Solvency Analysis

At a minimum the asset protection planning attorney should obtain from the potential client a statement whereby the client swears or affirms to the fact: (i) that the client has no pending or threatened claims; (ii) that the client is not presently under any investigation of any nature by the government; (iii) that the client is not involved in any administrative proceedings; (iv) that no situation has occurred which the client has reason to believe will develop into a legal problem in the future; (v) that following any intended transfers the client will remain solvent and able to pay the client's reasonably anticipated debts as they become due; and (vi) that none of the assets which the client may transfer was derived from any of the "specified unlawful activities" which are set forth under the Money Laundering Control Act of 1986.[116]

[116] 18 USC §1956.

Of course, the client may not be able to swear or affirm to each of the statements set forth above because, for example, a threatened claim often serves as the impetus for engaging the services of an asset protection planning attorney. Although, the existence of a threatened or pending claim does not necessarily warrant the flat rejection of a client for asset protection planning, additional caution and more limited planning is generally warranted. If the client has any pending or threatened claims, the attorney should ensure that those claims have been fully disclosed to the attorney (including an independent verification of the client's account as the client has related it to the attorney) and should absolutely reject any client who has proven less than completely forthcoming in this regard. If it remains appropriate to establish an asset protection plan for a client in such circumstances, the plan should ensure that appropriate steps have been taken to guarantee that adequate funds will be reserved by the client to make future payment to the claimant.

In the alternative, the planning documents should be drafted with provisions requiring that any liability which may result from the existing claims shall be satisfied by the transferee entity or entities in the event that the liability is not ultimately otherwise satisfied directly by the client.

3. "Due Diligence" Procedures

Since all of the ethical proscriptions against assisting in a fraudulent conveyance, as well as the potential for civil or even criminal liability, rest upon the attorney having acted "knowingly" (which term is almost always also deemed to include what reasonably *should* have been known by the attorney), due diligence will serve as the asset protection attorney's best defense against the potential for liability. At a minimum, the asset protection attorney's due diligence procedures should generally include the following:

(1) The attorney's receipt of a retainer letter, signed by the prospective client, which clearly sets forth, (i) what constitutes a fraudulent conveyance under local law, (ii) the potential consequences to the client of the making of a fraudulent conveyance, (iii) that the attorney will not assist the client in any transfer which the attorney believes might constitute a fraudulent conveyance, (iv) that the attorney is necessarily relying upon full and continuing disclosure by the client in the attorney's assessment of whether the transfers at issue are, in fact, permissible, and (v) that a breach of the client's required full and continuing disclosure will constitute grounds for the attorney to resign as counsel;

(2) The prospective client should be required to complete a client questionnaire which will collect information regarding, (i) any lawsuits in which the client is named as a party, (ii) whether the client, or any company with which the client has been closely connected, has ever filed for relief in bankruptcy, (iii) whether the client's federal, state and local tax reporting is current (and if not, why it is not), (iv) whether the client is currently being audited by any tax authority, (v) whether the client is aware of any legal actions threatened to be brought against the client, (vi) confirming that following any intended transfers the client will be in a position to pay all current bills as they come due and settle all outstanding debt, and that the client will retain sufficient assets to cover both his or her current and anticipated obligations and any potential personal emergencies; (vii) whether the client has any direct or indirect liability for any loan; and (viii) whether the client or any company with which the client has been closely connected has ever been convicted of a crime. Any issues which are brought to light by reason of the information obtained would obviously require further examination;

(3) The prospective client should be required to provide the following documentation for the attorney's review, (i) copies of the client's most recent personal income tax returns, as well as a current personal financial statement, and (ii) if the client is closely connected with any company,

copies of that company's most recent income tax returns, as well as a current financial statement of the company;

(4) The prospective client should be required to provide personal references from one or more of the client's primary banker, the client's personal attorney, the client's personal accountant and, if different, the client's personal tax return preparer, as well;

(5) Notwithstanding the information provided by the prospective client, an independent search should be undertaken to uncover, (i) any lawsuit in which the client or any company with which the client is closely connected is named as a defendant, (ii) any judgment under which the client or any company with which the client is closely connected is named as a judgment debtor, (iii) any liens which have been filed against the client, and (iv) any bankruptcy filings which may have been made by the client or any company with which the client is closely connected, at any time.

In the end, and in the absence of hindsight, the question of what steps will be deemed to constitute an appropriate level of due diligence will always remain subject to the facts and circumstances of the case at issue, as well as to differences of opinion. The potential consequences of a failure to conduct sufficient due diligence in the area of asset protection planning, however, seemingly warrants an excess of caution.

II. Fraudulent Transfers

A. General

Fraudulent transfer law in the United States is largely governed by one of two main bodies of law promulgated by the National Conference of Commissioners on Uniform State Laws; the Uniform Fraudulent Conveyance Act and the substantially more recent Uniform Fraudulent Transfer Act.[117] In those few states which have adopted neither the Uniform Fraudulent Conveyance Act nor the Uniform Fraudulent Transfer Act, common law provides the basis for prohibiting the fraudulent transfer [118] of property.[119] Although the particulars of fraudulent transfer law may vary from state to state, this relatively uniform proscription against the conveyance of property under certain specified circumstances is universally recognized as a necessary protection for the legitimate interests of unsecured creditors in a debtor's property.[120]

[117]The Uniform Fraudulent Conveyance Act was promulgated by the National Conference of Commissioners on Uniform State Laws in 1918 and remains in effect in only six jurisdictions. The Uniform Fraudulent Transfer Act was approved by the National Conference of Commissioners on Uniform State Laws in 1984 and is in effect in 37 jurisdictions.

[118]The terms "fraudulent conveyance" and "fraudulent transfer" will be used interchangeably in this portfolio unless specific reference is made to a particular Uniform Act.

[119]The earliest known prohibition against the transfer of property with the "intent to

delay, hinder or defraud creditors" is the English Statute of Elizabeth of 1571, 13 Eliz. 1, c.5. The Statute of Elizabeth provides, in pertinent part, "that all and every feoffment, gift, grant, alienation, bargain and conveyance of lands, tenements, hereditaments, goods and chattels, or for any of them, or of any lease, rent, common or other profit or charge out of the same lands, tenements, hereditaments, goods and chattels, or any of them, by writing or otherwise, and all and every bond, suit, judgment and execution, at any time had or made ... to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken ... to be clearly and utterly void, frustrate, and of none effect; any pretence, colour, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding." *See also* the Fraudulent Assignments Act of 1736, which provides that "all fraudulent Assignments or Transfers of the Debtor's Goods or Effects shall be void and of no effect against his just Creditors, any Custome or Practice to the contrary notwithstanding."

[120]According to the United States Supreme Court in *Adler v. Fenton*, 65 U.S. 407, 16 L.Ed. 696 (1860), "[u]nquestionably, the claims of morality and justice, as well as the legitimate interests of creditors, require there should be protection against those acts of an insolvent or dishonest debtor that are contrary to the prescriptions of law, and are unfaithful and injurious ... Bankrupt and insolvent laws, laws allowing of attachment and sequestration of the debtor's estate, and for the revocation of fraudulent conveyances, creditors' bills, and criminal prosecutions for fraud or conspiracy, are some of the modes that have been adopted for the purpose." See also *Grupo Mexicano de Desarollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999) ("we suspect there is absolutely nothing new about debtors' trying to avoid paying their debts, or seeking to favor some creditors over others -- or even about their seeking to achieve these ends through "sophisticated ... strategies,"...The law of fraudulent conveyances and bankruptcy was developed to prevent such conduct").

A complete understanding of the law of fraudulent transfers is integral to the practice of asset protection planning since most asset protection planning techniques involve, at some level, the transfer of property from one person to another person and, to the extent that the transferor later becomes a debtor the creditor may seek to have the transfer deemed to be a "fraudulent transfer," in order to undo the transfer and thereby vitiate the asset protection.[121]

[121]*See* Uniform Fraudulent Conveyance Act §§9-10; Uniform Fraudulent Transfer Act §7.

1. Definition

Notwithstanding the semantic similarity between the terms "fraud" and "fraudulent conveyance," the two concepts are wholly unrelated under the law. According to *Black's Law Dictionary*, a "fraud" is "knowing misrepresentation of the truth or a concealment of a material fact to induce another to act to his or her detriment." [122] By contrast, the most common incidence of a "fraudulent conveyance" is merely a transfer made with the intent to hinder, delay or defraud a creditor.[123] The difference between a fraud and a fraudulent conveyance is also evidenced by the remedy available to the injured party; fraud vitiates all transactions *ab initio*, whereas a fraudulent conveyance is merely voidable.

[122]*Black's Law Dictionary* 670 (7th ed. 1999). "Elements of a cause of action for fraud include false representation of a present or past fact made by defendant, action in

reliance thereupon by plaintiff and damage resulting to plaintiff from such misrepresentation." *Citizens Standard Life Ins. Co. v. Gilley*, 521 S.W.2d 354, 356 (Tex. Cir. App. -- Dallas 1975) (no writ).

[123]See Uniform Fraudulent Conveyance Act §7 ("Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors"); Uniform Fraudulent Transfer Act §4(a)(1) ("A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (1) with actual intent to hinder, delay or defraud any creditor of the debtor.").

In addition to a transfer made with the intent to hinder, delay or defraud a creditor, a transfer made without fair consideration by a person who is insolvent, or who will be rendered insolvent by reason of the transfer, is also deemed to be a "fraudulent conveyance," and the determination of a fraudulent conveyance in such instance does not rely upon any arguably pejorative intent on the part of the transferor.[124] Under the Uniform Fraudulent Conveyance Act a person will be deemed to be "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." [125] Similarly, under the Uniform Fraudulent Transfer Act "[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." [126] A person is also deemed insolvent under the Uniform Fraudulent Transfer Act if he or she is generally not paying his or her debts as they become due.[127] Finally, a transfer made without fair consideration by a person who is engaged in a business, or who is about to be engaged in a business, for which the transferor's remaining property is unreasonably small, will also be deemed to be a fraudulent conveyance without regard to the transferor's actual intent.[128]

[124]See Uniform Fraudulent Conveyance Act §4 ("Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."); Uniform Fraudulent Transfer Act §5(a) ("A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.").

[125]Uniform Fraudulent Conveyance Act §2(1).

[126]Uniform Fraudulent Transfer Act §2(a).

[127]Uniform Fraudulent Transfer Act §2(b).

[128]*See* Uniform Fraudulent Conveyance Act §5 ("Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent."); Uniform Fraudulent Transfer Act §4(a)(2)(i) ("A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (2) without receiving a

reasonably equivalent value in exchange for the transfer of 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.").

a. Transfer

In most instances, whether the debtor has effected a "transfer" is not an issue which requires much effort to resolve as both the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act define the term "transfer" expansively. Under the Uniform Fraudulent Transfer Act, the term "transfer" is defined as including "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."[129] Similarly, under the Uniform Fraudulent Conveyance Act, the term "conveyance" is defined as inclusive of "every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or incumbrance." [130]

[129]Uniform Fraudulent Transfer Act §1(12).

[130]Uniform Fraudulent Conveyance Act §1.

b. Protected Creditors

Under the Uniform Fraudulent Transfer Act a "creditor" is defined as "a person who has a claim," [131] and a "claim" is defined 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." [132] The Uniform Fraudulent Conveyance Act provides a similar definition for "creditor" as being "a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent." [133] When these provisions are read in conjunction with §4(a) of the Uniform Fraudulent Transfer Act, which provides that a transfer may be fraudulent "whether the creditor's claim arose before or after the transfer was made or the obligation was incurred," and §7 of the Uniform Fraudulent Conveyance Act, which provides that a transfer may be fraudulent as to "either present or future creditors," it would seem as though transfers made years or even decades before a claim arose might ultimately be found to have been fraudulent when made.

[131]Uniform Fraudulent Transfer Act §1(4).

[132]Uniform Fraudulent Transfer Act §1(3).

[133]Uniform Fraudulent Conveyance Act §1; *see e.g.*, *Marcus v. Kane*, 18 F.2d 722 (S.D.N.Y. 1927) (one who has a right to maintain a tort claim but who has not yet recovered judgment at the time of transfer is nevertheless deemed to be a "creditor").

Notwithstanding the foregoing, however, a number of courts have drawn an important and entirely appropriate distinction between those future creditors who might not, as yet, have a matured claim against the debtor, but whose claims can be reasonably anticipated, and those future creditors who were not, and perhaps could not, have been contemplated by the debtor at the time of the transfer. Future creditors falling into that latter group might be called "potential future creditors" or "uncontemplated creditors." This distinction is important because it has a direct impact upon whether, in effecting the transfer, the debtor could have possibly possessed the required actual intent to hinder, delay or defraud creditors; the more remote the future creditor, the less likely that the debtor can be found to have the necessary bad intent. In other words, if a creditor is not an existing creditor at the time the transfer is made, the creditor must show that the debtor made the transfer with an actual intent to hinder, delay or defraud the creditor, and moreover, will be at a natural disadvantage in doing so since the creditor was necessarily non-existent at the time of the transfer.[134]

[134]*See e.g.*, *Babcock v. Eckler*, 24 N.Y. 623 (1862) (a transfer without consideration is not presumptively fraudulent against future creditors, for a subsequent indebtedness cannot be invoked to make that fraudulent which was honest at the time.).

In *First National Bank in Kearney v. Bunn*,[135] the debtor transferred his interest in his home to his spouse on November 20, 1972. On June 29, 1973, seven months after the home had been transferred, the debtor executed a promissory note to the plaintiff bank for $14,000. In October of 1974, after the debtor had defaulted on his note to the bank, the bank sued the debtor, attached the home and sought to have the conveyance of November 20, 1972 set aside as fraudulent. The Supreme Court of Nebraska, however, held that the bank's suit to set aside the 1972 transfer as fraudulent was properly dismissed. In particular, the court noted that "[a] different standard is applied to creditors whose debts are in existence at the time of conveyance, as opposed to subsequent creditors. A creditor whose debts did not exist at the date of a voluntary conveyance by the debtor cannot attack such conveyance for fraud unless he pleads and proves that the same was made to defraud subsequent creditors whose debts were in contemplation at the time." [136]

[135]195 Neb. 829, 832, 241 N.W.2d 127, 129 (1976).

[136]*Id. Accord Jayne v. Hymer*, 66 Neb. 785, 789, 92 N.W.2d 1019, 1020 (1902), wherein the Supreme Court of Nebraska held that "[i]n order to maintain a creditors' suit against a wife to set aside a conveyance of property made by a third person to her, the relation of debtor and creditor must have existed between the plaintiff and her husband at the time such conveyance was executed; or it must have been executed fraudulently, with the expectation on the part of the husband that he would become indebted to the plaintiff at a future time, and for the purpose of preventing, hindering and delaying the collection of the debt when it should finally be contracted."

In *Hurlbert v. Shackleton*,[137] Dr. Shackleton, motivated by the fact that his medical malpractice insurance was soon to be cancelled, began transferring assets that were in his name alone to himself and his wife. Subsequent to the transfers at issue, Dr. Shackleton committed medical malpractice and a judgment was ultimately entered against him by reason thereof. When the plaintiff attempted to enforce her judgment against assets which had been transferred to Mrs. Shackleton, however, "the trial court drew a distinction between `probable' and `possible' future creditors. Classifying the plaintiff as merely being a `possible' future creditor, the trial court said it found no cases holding a transfer of assets to be fraudulent as to `possible' future creditors." [138] On appeal by the plaintiff, the appellate court remanded the matter for further findings of fact with regard to Dr. Shackleton's actual intent in effecting the transfers to his wife. In this regard, and although the appellate court stated that whether the subsequent creditor was "possible" or "probable" was not the relevant inquiry, the appellate court did note that "where the creditor is not in existence at the time of the conveyance, there must be evidence establishing actual fraudulent intent by one who seeks to have the transaction set aside." [139] Also instructive is the opinion of the dissent in that case, which would have affirmed the trial court's judgment in favor of Dr. Shackleton. The *Hurlbert* dissent stated that:

> I cannot conceive of any result being reached by the trial judge that would afford this judgment creditor any relief upon remand. The trial judge is unequivocal in his conclusion that this creditor was not contemplated by the law against fraudulent transfers. How could the trial judge now conclude that Dr. Shackleton had the actual intent to defraud this unknown, unintended victim of a future negligent act, or anyone else similarly situated? ... In each case discussed by the parties and the majority opinion, the future creditors were identifiable individually or as a class at the time of transfer, and each case dealt with financial and business transactions where financial credibility was a principal ingredient in the parties' dealings. In the instant case, future victims of Dr. Shackleton's medical malpractice were not identifiable individually or as a class, since the record contains no evidence that Dr. Shackleton intended to commit malpractice or suspected that he would be guilty of malpractice.[140]

[137] 560 So.2d 1276 (Fla. Ct. App. 1990).
[138] *Id.* at 1279.
[139] *Id.* at 1279-1280.
[140] *Id.* at 1280.

The New York courts first lent their support (albeit implicitly) to this distinction between future foreseeable creditors and future potential creditors in *Klein v. Klein*.[141] In that case title to the parties' marital residence was taken in the name of the defendant wife because the parties were concerned that "as a police officer [the plaintiff husband] might, at some future time, be sued for false arrest or some other act in connection with his duties in the enforcement of the law. And if any such claims came, the municipality had made no provision, by insurance or otherwise, to protect its employees from any valid claims or false ones."[142] It was, therefore, agreed by the parties that the deed should be taken in the name of the defendant wife, with the understanding that when the plaintiff husband retired from the police force the property would be deeded by the wife to her husband and herself, as tenants by the entirety. Subsequently, however, the parties had a falling out and the wife refused to re-title the property as tenants by the entirety upon the husband's retirement. In defense of her refusal to abide by the terms of the parties' agreement, the wife suggested fraud in the making of the oral agreement to transfer title.