Ethical Considerations in Asset Protection Planning

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A. What Does "Ethical" Mean in the Context of Asset Protection Planning?

An asset protection plan consists of one or more lawful transfers of assets and/or establishment of structures for holding assets. Asset protection plans are primarily undertaken by individuals for estate or business planning reasons as such plans reduce the risk of future and unforeseen creditors being able to reach the assets transferred or held.[2]

Asset protection planning encompasses a broad range of structures which are, for the most part, commonly used in estate planning and business planning. These structures include, but are not limited to: family limited partnerships, credit shelter trust arrangements (which are designed to maximize estate tax exemption amounts and avoid probate costs) and the use of liability limiting entities (such as limited liability companies) to shield personal assets from business liabilities.

Other asset protection devices exist which are more specifically focused on shielding assets from future creditor claims include offshore and more recently, domestic, asset protection trusts. These trusts are self-settled spendthrift trusts, meaning that the grantor has the enjoyment of the trust assets while at the same time shielding the trust assets from the reach of the settlor's creditors.

"Ethical" in the context of asset protection planning, and particularly in the context of asset protection trusts, involves many issues, including (1) the morality of asset protection planning; (2) an attorney's duty to counsel the client regarding asset protection planning; (3)

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[1] Special thanks to law clerk Kristy L. Burdick, Mansfield Tanick & Cohen, P.A., for her assistance in preparing these materials.

[2] John W. Ambrecht, "Asset Protection Trusts: an Important Ingredient in the Estate Planning Process", Presentation to the Annual Taxation Section Meeting of the Taxation Section of the California State Bar, in San Francisco, California, on November 4, 2000, citing William K. Norman, Esq., CEB Program on Estate Asset Protection Planning, Emerging Issues, (May 1999), p. 5.

fraudulent transfer issues arising out of an asset protection plan (and the risk of discipline of the attorney); (4) unauthorized practice of law issues; and (5) in select circumstances, issues concerning joint representation of a husband and wife in connection with an asset protection planning. It is the interaction and interplay of these issues that encompass the great majority of the ethical quandaries faced by an attorney.

1. The Ethics of Asset Protection Planning From a Moral Perspective

The first ethical issue to consider with regard to asset protection planning is the propriety of asset protection planning in and of itself.

The desire to protect one's assets from creditors is as old as the obligation to pay one's debts.[3] The earliest reported decision involving fraudulent transfers is Twyne's Case, a 1601 decision of England's Star Chamber.[4] Twyne's Case involved a party named Pierce who not wanting to have all of his assets taken by the plaintiff creditor who had obtained a judgment against him, transferred all of his assets to his friend, Twyne.[5] When the Sheriff came to execute the creditor's judgment, Pierce told him that all of the assets were Twyne's, even though Pierce continued to have the use of such assets. Pierce's actions were challenged and the transfers to Twyne were voided as violations of the Statute of Elizabeth, the predecessor of current fraudulent transfer law.[6] Hence, the assets transferred to Twyne by Pierce were available to satisfy the debts of Pierce's creditors.

The traditional rule pertaining to creditors provides that when a person creates a trust for his own benefit, creditors may reach his interests, regardless of whether the settlor limits his

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[3] Claudia R. Tobler and Ingrid Michelsen Hillinger, *Asset Protection Devices: Twyne's Case Re-Told*, 9 J. BANKR. L. & PRAC. 3, 3 (1999).
[4] 76 Eng. Rep. 809 (1601); *see also* Claudia R. Tobler and Ingrid Michelson Hillinger, *Asset Protection Devices: Twyne's Case Re-Told*, 9 J. BANKR. L. & PRAC. 3, 3 (1999).
[5] *Id.*
[6] *Id.*

ability to transfer his interest.[7] This traditional rule is embodied by the Uniform Trust Code and Restatement (Third) of Trusts.[8]

Analyzing asset protection from a moral perspective deals with resolving the clash between the long-held principle that a person should not be able to shield assets from his/her creditors while using and enjoying those assets, with the understanding that as American society becomes increasingly litigious, certain individuals – especially high wealth individuals involved in occupations with a high risk of liability – are required to take steps to protect their wealth from future unforeseen creditors.[9]

An asset protection trust allows a settlor to shield his assets from creditors while at the same time exercising some control over the trust. Until recently asset protection trusts were available only in foreign jurisdictions.[10] However, seven states now allow individuals to create domestic asset protection trusts.[11] A domestic asset protection trust is an attractive tool for a client with assets above and beyond what is needed for his/her estimated liabilities and with a desire to protect those assets from future, unforeseen liabilities. However, in light of recent case law threatening the stability of traditional asset protection techniques, a domestic asset protection trust may become a necessary tool.[12]

The "morality" of asset protection planning depends heavily on the settlor's intent in establishing the asset protection plan and the timing of the transfers associated with the asset protection plan. For instance, absent a pending lawsuit, judgment, bankruptcy, divorce or similar

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[7] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263, 268 (2005).
[8] UTC § 505, subd. a(2); *see also* RESTATEMENT (THIRD) OF TRUSTS § 58, subd. 2.
[9] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 at 270.
[10] *Id.*
[11] *Id.* at 271 (the six states are: Alaska, Delaware, Rhode Island, Nevada, Utah, Oklahoma and South Dakota).
[12] *Id.*; *see also United States v. Craft*, 535 U.S. 274 (2002) (Court enforced federal tax lien on the wife's husband's interest in their tenancy by the entirety).

event, it would seem perfectly reasonable for an individual to establish and fund an asset protection plan to shield his or her assets from the reach of unforeseen future creditors. The creation of an asset protection trust upon notice of divorce proceedings with the intent to frustrate a spouse's claims, on the other hand, raises red flags. Nonetheless, under the right circumstances, an asset protection plan can be as ethical as it is valuable.

2. The Attorney's Duty to Inform the Client about Asset Protection Planning

A second ethical issue is whether an attorney has a duty to inform his client of the existence of various asset protection planning devices and, if a duty is owed, what steps the attorney must take to evaluate the client as a possible candidate for an asset protection plan. This issue is discussed in detail at Section B herein.

3. Fraudulent Transfer Issues Arising From Asset Protection Planning

A third ethical issue is whether the asset protection plan constitutes a fraudulent transfer giving rise to liability issues for both the attorney and client (and possible disciplinary action for the attorney). This is a mechanical statutory analysis and is a function of the timing of the implementation of the asset protection plan (such as the presence of one of the circumstances referenced above at Section A(1)) and the client's objectives in creating the plan, including the context in which the client consults the attorney with regard to the desire to create the plan. This issue is addressed more fully at Section D(1) herein.

4. Unauthorized Practice of Law Issues

A fourth ethical issue arises when an attorney establishes an asset protection plan which is governed by the law of a state in which the attorney is not licensed. In that instance, the attorney needs to be aware of that state's position on what constitutes the unauthorized practice of law. This issue is raised predominantly in the context of domestic asset protection trusts, when an attorney seeks to create an asset protection trust under the laws of a state which permits such trusts (i.e., Alaska, Delaware, Rhode Island, Nevada, Utah or South Dakota). For example, is an attorney who is not licensed in the state whose law will govern the trust engaging in the unauthorized practice of law by establishing such a trust? The answer is probably no, as long as the attorney complies with the ABA Model Rules of Professional Conduct. The rules on multijurisdictional practice permit an attorney of one state to provide legal services in another state on a temporary basis.[13] Specifically, the rules provide that an attorney may practice temporarily in another jurisdiction if (i) local co-counsel is engaged, or (ii) the legal services are related to a pending or potential legal proceeding, or (iii) legal services are related to a pending or potential alternative dispute resolution proceeding, or (iv) the legal services are reasonably related to the attorney's practice in his home jurisdiction.[14] While the rules governing multijurisdictional practice are rather precise, adherence to them will avoid an unauthorized practice of law issue.[15]

5. Representation of Conflicting Interests

A fifth ethical consideration in asset protection planning situations involves the potential for conflicts of interests and attorney representation in light of the conflicts.

If an attorney provides clients with full disclosure of a conflict of interest and obtains the client's consent he can represent the clients despite the conflict of interest.[16] In addition to the requirements of full disclosure and consent, an attorney must have a reasonable belief that representation in light of the conflict of interest will no adversely affect any of the parties.[17]

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[13] Model Rules of Professional Conduct, Rule 5.5; *see also* Minn. R. Professional Conduct, 5.5.
[14] *Id.*
[15] *See* George A. Riemer, *A State of Flux, Trends in the Regulation of the Multijurisdictional Practice of Law*, 64 OR. ST. B. BULL. 19, 20 (Aug./Sep. 2004).
[16] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS § 2.02-3 (Warren Gorham Lamont 2006)(2001).
[17] *Id.*

A conflict of interest that may arise for an asset protection attorney stems from asset protection planning for elderly clients, as the children of the clients typically contact an attorney, not the client himself.[22] If an attorney is paid for his services by the children of the client, a conflict of interest may arise.[23] To avoid a conflict of interest an attorney should always[24]:

1. obtain the consent of the client;
2. remain independent from the influence of the client's children; and
3. keep all information between only himself and his client.

In addition to conflicts of interests arising in asset protection for the elderly, conflicts of interest may also arise within the context of marriage. When representing a married couple, an attorney owes an attorney-client privilege to the couple, not to the individuals alone.[31] Plans of divorce or separation bring an attorney into a field of conflict of interest land mines; as an attorney violates the his ethical duties if he assists one spouse to the detriment of the other.[32]

If a divorce ensues, the attorney must pick a side so to speak, and represent only one client. Even then, an attorney must take care in assisting his client as asset protection in the

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[22] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS § 2.02-3 (Warren Gorham Lamont 2006)(2001).
[23] *Id.*
[24] *Id.*
[31] Peter R. Brown and George L. Cushing, *Understanding "Estate Planning": Asset Protection or Fraudulent Conveyance*, 16 J. AM. ACAD. MATRIM. LAW 347, 376 (2000).
[32] Peter R. Brown and George L. Cushing, *Understanding "Estate Planning": Asset Protection or Fraudulent Conveyance*, 16 J. AM. ACAD. MATRIM. LAW 347 at 376-377.

context of divorce can easily bring up ethical violations. For instance, a client may wish to transfer assets during a divorce proceeding solely to frustrate spousal claims. Assisting a client in this type of transfer is unethical due to the client's fraudulent motives.[33] However, if a client seeks to transfer assets just in case he/she gets divorced, an attorney can likely assist the client without violating an ethical rule.[34]

B. The Client's Right to Asset Protection Planning

An attorney is ethically bound to provide competent representation to his client.[36] Competent representation requires that an attorney possess the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.[38]

In the context of asset protection planning, the above-stated rules pertain to an attorney's knowledge of the laws of the jurisdiction in which an asset protection trust lies. Aside from the unauthorized practice of law issue discussed herein, attorneys that engage in asset protection involving the transfer of assets to such a trust are required either to know these foreign laws or to engage local counsel, as attorneys are charged with knowing the laws of the foreign jurisdictions that may be material to the task at hand.[42]

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[33] *Id.* at 373 ("If the client's motives are not fraudulent and such authority exists, the lawyer may find sanctuary from discipline under the good faith rule, even if the transfers are ultimately deemed fraudulent.").
[34] *Id.* at 373-374.
[36] Minn. R. Professional Conduct, Rule 1.1.
[38] *Id.*
[42] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.04-1.

Although an attorney is not likely to be held liable for the failure of an asset protection plan, he is highly likely to violate his ethical duty of competence if he fails to adequately complete the paperwork and formation of an asset protection trust.[43]

A separate aspect of the ethical duty of competent representation arguably requires an attorney to inform his client of the availability of asset protection planning in certain circumstances.[44] For instance, if a client has significant assets and is in a highly regulated industry, he may be well served with an asset protection plan. Provided that the client is solvent and is not subject to pending litigation, as asset protection plan is both legal and likely advisable. An attorney that does not advise this type of client of the availability of an asset protection plan arguably violates his ethical duty of competence.[45]

C. Application of the Rules of Professional Conduct

An attorney assisting a client with asset protection must be aware of the professional rules of conduct in both his jurisdiction as well as in the jurisdiction that the assets are transferred to.[46] Although the rules of professional conduct do not specifically address asset-protection planning, the rules do take a strong stance against assisting clients in fraudulent acts.[47] Specifically, the American Bar Association Model Rules provide that[48]:

> "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law."

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[43] *Id.* at § 2.04-4.
[44] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.01.
[45] *See id.*
[46] *See* Henry J. Lischer, Jr., *Professional Responsibility Issues Associated with Asset Protection Trusts*, 39 REAL PROPERTY, PROBATE AND TRUST JOURNAL, Fall 2004, at 599.
[47] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 at 283.
[48] Model Rules of Professional Conduct, Rule 1.2, subd. d; *see also* Minn. R. Professional Conduct, 1.2, subd. d.

On the basis of this rule, it is unethical for an attorney to protect a clients assets from judgments or claims of creditors. However, an attorney will not violate his ethical rules in advising a client to use asset protection to avoid potential financial difficulty.[49] The trigger for liability is the existence of fraudulent or criminal intent.

1. Rule 1.2

Rule 1.2 of the Minnesota Rules of Professional Conduct provides as a general rule that "a lawyer shall abide by a client's decisions concerning the objectives of the representation and . . . shall consult with the client as to the means by which they are to be pursued."[50] However, "a lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal *or fraudulent*, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law [emphasis added]."[51]

2. Rule 8.4(e)

Rule 8.4(e) of the Minnesota Rules of Professional Conduct provides that "it is professional misconduct for a lawyer to . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation."[53]

3. Rule 4.4(a)

Rule 4.4(a), Minnesota Rules of Professional Conduct provides that "in representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass,

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[49] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.03-6-b.
[50] Minn. R. Professional Conduct, 1.2, subd. a; *see also* Model Rules of Professional Conduct, Rule 1.2.
[51] Minn. R. Professional Conduct, 1.2, subd. c, *see also* Model Rules of Professional Conduct, Rule 1.2, subd. d.
[53] Minn. R. Professional Conduct, 8.4, subd. c.

delay, or burden third person, or use methods of obtaining evidence that violate the legal rights of such a person."[54]

4. Disciplinary Concerns With Regard to Domestic Asset Protection Trusts.

With the recent legislation authorizing domestic asset protection trusts (i.e., self-settled spendthrift trusts) in Alaska, Delaware, Nevada, Oklahoma, Rhode Island, South Dakota, and Utah, there is a concern regarding the applicability of the rules of professional conduct of a non-asset protection trust state (such as Minnesota) for an attorney advising and/or assisting a client with the creation and funding of a domestic asset protection trust. No direct authority currently exists addressing this issue.

In the absence of direct precedent, a split has developed among commentators as to the disciplinary considerations a non-Asset Protection Trust state attorney faces in creating a Domestic Asset Protection Trust under the laws of another state.

a. Minority View: Creation of Domestic Asset Protection Trusts Under Foreign State Could Lead to Discipline in Non-Domestic Asset Protection Trust state

The minority view believes that, assuming that a creditor commences an action in a non-asset protection trust jurisdiction under that jurisdiction's fraudulent transfer statute, and in accordance with the Restatement (Second) of Conflict of Laws, the governing law as to whether the creation and funding of an APT is the law of the non-APT jurisdiction. Hence, the creditor would be able to avoid the transfer under a fraudulent transfer theory.[55]

If the creation and/or funding of the Domestic Asset Protection Trust is analyzed under the laws of a non-Asset Protection Trust jurisdiction, cases from other jurisdictions indicate that

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[54] Minn. R. Professional Conduct, 4.4, subd. a.

[55] *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035 (2001); *see also* Henry J. Lischer Jr., *Professional Responsibility Issues Associated with Asset Protection* Trusts, 39 REAL PROPERTY, PROBATE AND TRUST JOURNAL 562, at 557-576.

an attorney in a non-Asset Protection Trust jurisdiction who assists a client with the creation and funding of an APT may be subject to ethical discipline in the non-Asset Protection Trust jurisdiction.

i. *In Re Whitbeck*, 284 A.D.2d 80 (N.Y.A.D. 1 Dept., 2001): the general counsel for a group of companies participated in effecting transactions which would make the companies judgment proof. The attorney stipulated to the Departmental Disciplinary Committee of New York's First Judicial Department that his conduct violated DR 7-102(A)(1) ("a lawyer shall not…take…action on behalf of his client when he knows or when it is obvious that such action would serve merely to harass or maliciously injure another"). As a result, the New York Supreme Court, Appellate Division, First Department, suspended the attorney from the practice of law within the State of New York for a period of four (4) years.

ii. *In Re Conduct of Hockett*, 734 P.2d 877 (Or. 1987): an Oregon attorney handled two divorce proceedings which involved property transfers from husbands to wives. The divorces and transfers were part of a course of conduct designed to hinder the husbands' creditors. The Oregon Supreme Court found that (i) the attorney's assistance in the fraudulent conveyance was with intent to cheat creditors and was conduct involving dishonesty that violated DR 1-102(A)(7) ("a lawyer shall not…[c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent") and suspended the attorney from the practice of law for 63 days.

iii. *Florida Bar v. Cohen*, 534 So.2d 392 (Fla. 1988): Florida attorney advised his client, the sole shareholder of a corporation, to execute a mortgage and a note from the corporation to both the client and the attorney. The client and the attorney in turn foreclosed on the mortgage and in the process the attorney filed an affidavit of indebtedness claiming that the corporation owed the client and the attorney the principal amount of the note plus interest. The referee in the disciplinary proceeding found that no valid indebtedness in favor of either the client or the attorney existed and the purpose of the transaction was to avoid paying high liability insurance premiums and damages to claimants against the corporation. The attorney was sanctioned for violations of DR 1-102(A)(4) ("engaging in conduct involving dishonesty, fraud, deceit, or misrepresentation") and DR 7-102(A)(7) ("counseling or assisting his client in illegal or fraudulent conduct").

iv. *Florida Bar v. Klein*, 774 So.2d 685 (Fla. 2000): Florida attorney participated in a fraudulent transfer by a corporation which subsequently filed for bankruptcy. The attorney prepared and filed articles of incorporation for a second corporation to which were assigned the assets of the corporation which filed for bankruptcy, as well as the transfer documents. The attorney was sanctioned for violating Florida Ethical Rule 4-8.4(c) which prohibits "conduct involving dishonesty, fraud, deceit [or] misrepresentation" and Florida Ethical Rule 4-8.4(d) which precludes "conduct prejudicial to the administration of justice." The attorney was disbarred for these violations.

v. *Matter of Kenyon*, 491 S.E.2d 252 (S.C. 1997): Two South Carolina attorneys participated in a conveyance of a deceased client's real property for the purpose of creditor avoidance. The Supreme Court of South Carolina determined that the attorneys violated DR 1-102(A)(4) and Model Rule 1.2 (d). The Court determined that one of the attorneys was more culpable and suspended that attorney indefinitely. The second attorney received a public reprimand. It is interesting to note that in the *Kenyon* decision, the Court, citing favorably to *Conduct of Hockett*, held that a finding that the conduct involved did not meet the definition of a "fraudulent conveyance" was not necessary for the Court to determine that the attorneys' conduct warranted discipline for violation of the aforementioned rules.

vi. *In re De Pamphilis*, 153 A.2d 680 (N.J. 1959): In a case which predated the ABA Model Rules and ABA Model Code, the Supreme Court of New Jersey disciplined two attorneys who transferred a client's property to a third party in an effort to avoid creditors. The Court, relying upon the ABA Canons of Professional Ethics, referred to Canon 29 ("the attorney should "strive at all times to uphold the honor and to maintain the dignity of the profession"), Canon 15 ("[t]he office of attorney does not permit, much less does it demand of him for any client, violation of law or any manner of fraud or chicane"), Canon 32 (a lawyer may not "render any service or advice involving disloyalty to the law whose ministers we are…when rendering any such improper service or advice, the lawyer invites and merits stern and just condemnation") and Canon 15 ("[t]he lawyer 'must obey his own conscience and not that of his client'"). The Court accordingly found that the attorneys' conduct warranted reprimand.

vii. *Townsend v. State Bar of California*, 197 P.2d 326 (Cal. 1948): A California attorney knowingly advised his client to make a conveyance of real property for the purpose of delaying and defrauding the creditors of his client in violation of California law. The Supreme Court of California suspended the attorney from the practice of law.

viii. *Minnesota Precedent*. <u>No</u> existing Minnesota precedent exists as to the extent an attorney would be subject to discipline for assisting the client with a fraudulent transfer in violation of statute.

b. Majority View: Creation of Domestic Asset Protection Trusts Under Foreign State Does Not Lead to Discipline in Non-Domestic Asset Protection Trust state

The majority view believes that a non-domestic asset protection trust state attorney assisting in the creation of a domestic asset protection trust does not create the risk of ethical discipline in the non-domestic asset protection trust state.[56] This assertion is generally supported by the assertion that in obtaining co-counsel in an domestic asset protection state, an attorney can avoid ethical concerns.[57]

Moreover, the asset protection trust statutes adopted by Alaska and Delaware provide protection for attorneys involved in the creation and administration of the asset protection trust.[58] In addition, the Utah asset protection trust statute provides for limited protection.[59] These "safe harbors" would seem to protect a non-asset protection trust state attorney who assists a client with the creation of a domestic asset protection trust, especially given the operation of the Full Faith and Credit Clause.

Regardless of the competing views, it should be noted that these issues are most prevalent where one of the "hot button" circumstances exist (i.e.: judgment, bankruptcy or divorce) where fraudulent intent can be proven. It does not seem reasonable that the creation of a Domestic Asset Protection Trust outside of the context of these circumstances would give rise to any ethical discipline under a non-Domestic Asset Protection Trust state because the threshold issue of the attorney's participation in a fraudulent transfer is not present.

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[56] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 at 348.
[57] *Id.*
[58] *See* Alaska Stat. § 34.40.110(e); *see also* Del. Code. Ann. tit. 12, § 3590.
[59] *See* Utah Code.Ann. § 25-6-14(4)(a).

D. Potential Problems for the Client

1. Fraudulent Transfer Laws

The fraudulent transfer laws followed in the United States stem from four sources, all of which were derived from a single common-law source.[60] As a result, the case law interpreting fraudulent transfer laws is consistent regardless which of the four sources is followed. Generally, under all four fraudulent transfer rules, a transfer is fraudulent if either: the transferor was insolvent or about to become insolvent at the time of the transfer, the transfer leaves the transferor with unreasonably small capital, or the transferor is about to incur debts beyond his ability to pay at the time of the transfer.[61]

The four commonly used fraudulent transfer rules are[62]:

1. Common law – Statute of Elizabeth
2. The Uniform Fraudulent Conveyance Act (UFCA)
3. The Bankruptcy Code
4. The Uniform Fraudulent Transfer Act (UFTA)

In certain limited circumstances other statutory law can supersede enforcement of the above-listed fraudulent transfer laws.[63] These circumstances include fraudulent transfers for the benefit of a disabled individual.[64] Aside from these limited circumstances, enforcement of the above-listed fraudulent transfer laws can be avoided

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[60] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.02.
[61] *Id.* at § 3.01-2.
[62] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 Real Prop. Prob. & Tr. J. 263 at 276.
[63] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.02.
[64] *Id.*

with a disclaimer as provided for by state law.[65] Further, depending on applicable state law, disclaimers are often exempted from the fraudulent transfer laws.

A. Common Law Fraudulent Transfer Law – Statute of Elizabeth

Common law in the United States is generally derived from the Statute of Elizabeth, which is the first statutory embodiment of the prohibition against fraudulent transfers.[66] The Statute of Elizabeth voids transfers "made with the intent to hinder, delay, or defraud creditors of the transferor."[67] A transfer would be voided on this basis if the creditor could establish actual fraudulent intent on the part of the transferor.[68]

Although the UFCA and UFTA succeeded the Statute of Elizabeth in most jurisdictions, six states continue to follow the Statute of Elizabeth.[69]

B. Uniform Fraudulent Conveyance Act

The UFCA was approved by the National Conference of Commissioners on Uniform State Laws in 1918.[70] The UFCA differs from the Statute of Elizabeth in that it eliminated the need of a creditor to prove the fraudulent intent of the transferor in certain circumstances.[71] Other differences from the Statute of Elizabeth include a shift in the presumption of gifts, under the UFCA gifts are not presumed to be fraudulent.[72]

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[65] *Id.* ("The most common and controversial exception is the conversion of nonexempt assets to assets that are exempt from creditor claims.").
[66] *Id.* at § 3.02-1.
[67] *Id.*
[68] *Id.*
[69] Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 at 276.
[70] *Id.*
[71] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.02-2.
[72] *Id.*

C. Bankruptcy Code

The Bankruptcy Code became effective in 1979.[73] The Bankruptcy Code grants trustees substantial avoidance powers. Specifically, the Bankruptcy Code authorizes a trustee to avoid any transfers made with the intent to hinder, delay, or defraud creditors.[74] A trustee is also authorized to avoid any transfer in which the debtor becomes insolvent as a result of the transfer or as a result of under capitalization.[75]

The Bankruptcy Code also grants a trustee flexibility to act under state law; however the Code binds the trustee to any limitations imposed by the law.[76]

D. Uniform Fraudulent Transfer Act

The UFTA was approved by the National Conference of Commissioners on Uniform State Laws in 1984 and is in effect in most jurisdictions in the United States as a replacement to the UFCA. [77]

The UFTA was enacted to fill holes in the UFCA. Specifically, the UFTA brought uniformity of the fraudulent transfer laws with other federal laws. The UFTA also works to prevent avoidance of foreclosures and requires compliance with the American Bar Association Model Rules of Professional Conduct, which forbid an attorney from assisting a client with a fraudulent transfer.[78]

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[73] *Id.* at § 3.02-3.
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] The UFTA is in effect in forty-one states and the District of Columbia. Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 Real Prop. Prob. & Tr. J. 263 at 276; *see also* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.02-4.
[78] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.02-4.

The UFTA authorizes present and future creditors to set aside fraudulent transfers and reach a debtor's assets.[79] The UFTA recognizes four types of fraud: present actual fraud, present constructive fraud, future constructive fraud, and future actual fraud.[80] All four types of fraud are addressed in the UFTA, specifically:

> "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:
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> > (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or
> >
> > (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
> >
> > > (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
> > >
> > > (ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due."[81]

2. Civil Liability

Pursuant to the Uniform Fraudulent Transfer Act a creditor can bring suit against an individual who has fraudulently transferred assets out of his reach. Anyone involved in a fraudulent transfer may be court ordered to pay damages.[82] Damages are calculated by taking the lesser of either the value of the transferred property or the amount of

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[79] UFTA §§ 5, subd. a, and 4, subd. a; *see also* Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 at 276.
[80] *Id.* at 278.
[81] UFTA § 4, subd. a.
[82] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.05.

unsatisfied debt held by a creditor as a result of the fraudulent transfer.[83] In addition, upon a showing of actual malice, anyone involved in a fraudulent transfer may be ordered to pay punitive damages.[84]

3. Criminal Liability

Bankruptcy law serves as the primary basis for the criminal liability of clients (and attorneys alike) within the contexts of asset protection. Specifically, individuals can be criminally prosecuted under Title 18, Section 152 of the Bankruptcy Act for fraudulent transfers; and each transfer amounts to a separate offense.[85]

Under the 2005 reform the Bankruptcy Act provides that transfers to self-settled trust are subject to characterization as avoidance transfers.[86] Under a broad interpretation, this new law could stifle the effectiveness of asset protection trusts, as future creditors may be able to reach trusts established years before their claims against the debtor arose.[87]

In connection to criminal liability for bankruptcy fraud, individuals are also vulnerable to criminal money laundering charges for the use of funds that were fraudulently transferred.[88] Other potential criminal charges include: transporting stolen property; withholding assets from a financial institution; transferring property pledged to a foreign credit agency; tax evasion and concealment of property; defrauding financial institutions; making false statements to an agency of the United States; structuring a transaction to evade tax reporting requirements; failing to report a monetary transaction

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[83] *Id.*
[84] *Id.*
[85] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.05B-1; *see also* 18 U.S.C. § 152.
[86] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.05A; *see also* 18 U.S.C. § 152.
[87] *See id.*
[88] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.03-2; *see also* 18 U.S.C. § 1956.

over $10,000; failing to keep records of transactions with foreign financial agencies; and stealing from ERISA employee benefit plans.[89]

E. Potential Problems for the Attorney Advisor

A lawyer is under an ethical duty to "not counsel a client to engage, or assist a client, in conduct the lawyer knows or reasonably should know is criminal or fraudulent."[90] If an attorney engages in asset protection planning that involves fraudulent conveyances he may face civil and criminal sanctions.

1. Liability to Clients – Civil Liability

An attorney engaging in asset protection planning must be competent or consult competent co-counsel to prevent a malpractice action. As, an attorney opens himself up to a client malpractice claim if he advises the client in asset protection in a manner that constitutes a fraudulent conveyance. In Minnesota, to prove a claim of malpractice a plaintiff must establish[91]:

1. "the existence of an attorney-client relationship;
2. acts amounting to negligence or breach of contract;
3. that such acts were the proximate cause of plaintiff's damages; and
4. that but for defendant's conduct, plaintiff would have been successful in the action."

Further, to avoid a client's claim for damages under the UFTA an attorney must ensure that a client understand the legal impact of his or her asset protection plan. Thus, if a client seeks an asset protection plans with improper motivations (i.e.: frustrating a creditor's claims), an attorney must refuse to assist the client and explain the legal consequences of such a plan.

[89] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.03-3.
[90] Minn. R. Professional Conduct, 1.2, subd. d; *see also* Model Rules of Professional Conduct, Rule 1.2, subd. d.
[91] *Rouse v. Dunkley & Bennett, P.A.*, 520 N.W.2d 406, 408 (Minn. 1994).

Providing the client with information concerning the legal risks of a potential asset protection plan will insulate a attorney from liability, as a client acting against a clear warning from his attorney is typically deemed to be acting alone.[92]

Recent case law suggests that even without evidence of a clear warning of legal consequences, and attorney can avoid liability for his client's fraudulent transfers if the attorney merely involved in the formation of an asset protection plan. Specifically, in *Nastro v. D'Onofrio*, a federal district court in Connecticut separated an attorney and his firm from the liability of defendant for a fraudulent transfer.[93] The court reasoned that the attorney and his firm merely prepared the legal documents to create an offshore spendthrift trust; and that they did nothing more than provide legal services to a client that happened to have an improper motive.[94]

2. Liability to Third Parties – Civil Liability

An attorney may be liable to a third party if he acts with a client in effecting an asset protection plan that is designed to hinder or defraud third parties.[95] In these types of situations, a third party can sue an attorney for civil conspiracy.[96] Under Minnesota common law, conspiracy is defined as "a combination of persons to accomplish either an unlawful purpose or a lawful purpose by unlawful means."[97] A claim of civil conspiracy may only be proven with evidence of a wrongful act to an injured party.[98]

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[92] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.04-1.
[93] 263 F.Supp.2d. 446 (D. Conn. 2003).
[94] *Id.* at 459.
[95] *See* Glenn W. Merrick, *Representing the Debtor: Counsel Beware!*, 23 COLO. LAW 539, 542 (1994).
[96] *Id.*; *see also* Alexandria Fugairon, *Civil Conspiracy Arising from Fraudulent Transfers*, *available at* http://www.assetprotectionbook.com/civil_conspiracy_summary_Mar05.htm.
[97] *Harding v. Ohio Casualty Ins. Co.*, 230 Minn. 327, 337, 41 N.W.2d 818, 824 (1950).
[98] *Id.*

The Eleventh Circuit tempered an attorney's potential liability to third parties in *Freeman v. First National Bank*.[99] In that case the Eleventh Circuit held that there was no cause of action for aiding and abetting a fraudulent transfer under the Florida Uniform Fraudulent Transfer Act when the party assisting in the transfer is not a transferee.[100] Although on its face the *Freeman* holding appears to shield asset protection planning attorneys from liability, this is not so. The Eleventh Circuit may have tempered liability but did not shield it, as the court limited its holding to the contexts of liability under the Florida Uniform Fraudulent Transfer Act.[101]

On the other hand, an attorney is not typically liable to heirs or beneficiaries of an estate for an ineffective asset protection plan.[102] Due to the fact that asset protection plans are meant to protect the assets of the owners of the property, beneficiaries to that property typically can not hold an attorney liable for an ineffective asset protection plan because they benefit from the plan only indirectly.[103]

3. Criminal Liability

In addition to sanctions for violations of ethical codes and malpractice claims, an attorney assisting a client in fraudulent transfers is subject to criminal liability. Generally, an attorney taking part in a fraudulent transfer subjects himself to criminal liability under the Bankruptcy Act and various fraudulent transfer laws.[104]

Specifically, in the context of bankruptcy an attorney can be criminally prosecuted for concealing property in bankruptcy proceedings; similarly hiding assets from the Internal

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[99] 329 F.3d 1231 (11th Cir. 2003).
[100] *Id.* at 1234.
[101] *See* Barry A. Nelson, *Surprise! You May Already be an Asset Protection Attorney – Take the Quiz and Find Out,* FLA. B. J., Nov. 2005, at 10; *see also Morganroth & Morganroth v. Norris, McLauglin & Marcus,* 331 F.3d 406 (3rd Cir. 2003).
[102] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.04-5.
[103] *Id.*
[104] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at §§ 2.04-5 and 2.03.

Revenue Service may also trigger criminal liability.[105] Further, criminal money laundering charges may be brought against an attorney in connection with a fraudulent transfer.[106] In addition, an attorney can be vulnerable to criminal aiding and abetting charges as well as various other criminal charges discussed in Section D(3) herein.[107]

F. Some Guidelines to Live and Practice By

1. Comprehensive Intake Interview

As previously discussed in Section B herein, an attorney may have a duty to advise clients of the availability of asset protection planning. In order to avoid violating this ethical duty it is essential that an attorney conduct a thorough intake interview with the client.[108] Questions need to be asked about the client's potential need for asset protection. Obviously, if a client's answers to these questions indicate that an asset protection plan is inappropriate, an attorney is not duty bound to discuss the topic. However, if during an interview it becomes apparent that a client may be at risk for future substantial liability an attorney should advise the client of the benefits of an asset protection plan.

In order to identify whether a client has asset protection needs, the following information should always be inquired into: the client's ownership and fiduciary responsibilities; the client's tax information; and whether the client's business activities are subject to regulatory control.[109]

2. Extensive Due Diligence

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[105] Claudia R. Tobler, Ingrid Michelsen Hillinger, *Asset Protection Devices: Twyne's Case Re-Told*, 9 J. BANKR. L. & PRAC. 3 at 13.
[106] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.03-2.
[107] *See id.* at §§ 2.03-3 and 2-05-1-a.
[108] *See id.* at § 2.07.
[109] *See* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.07.01.

As with all attorneys an asset protection attorney should exercise due diligence. However, due to the stiff criminal and civil penalties linked to the practice of asset protection planning, attorneys engaging in this practice should take special care to ensure that they obtain enough information from a client to be sure that they are not be assisting the client in making a fraudulent transfer. Further, an asset protection attorney must be sure to follow the rules of the appropriate jurisdiction in creating domestic asset protection trusts to avoid a claim of attorney malpractice in addition to civil and criminal fraudulent transfer claims.

3. Determination of Client Solvency – Do Not Wait

In exercising due diligence an asset protection attorney must determine whether a client is solvent before initiating any sort of asset protection plan.[110] This is a crucial determination as courts will nearly always find a transfer to be fraudulent if the transferor was insolvent at the time of the transfer.[111] Whether or not a client is solvent depends on the laws of the jurisdiction involved; in jurisdictions that follow the Uniform Fraudulent Transfer Act (the majority), a client is solvent when his debts are greater than his assets.[112]

4. Have the Proper Engagement Agreement

Due to the fact that an asset protection attorney exposes himself to substantial liability issues, he should take the opportunity to avoid liability as much as possible in his retainer agreement.[113] A proper asset protection engagement agreement should address the following topics in detail: the services obtained by the attorney and his role

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[110] *Id.* at § 3.06.
[111] *Id.*
[112] UFTA § 2; *see also* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 3.06-01.
[113] Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at § 2.08.

(specifically, whether the attorney can consult with and delegate work to other attorneys); the scope of the services obtained; payment for the services; consequences and rights relating to potential conflicts; and the tax and legal consequences of the agreement.[114]

[114] *Id.* at § 2.08.01; *see also* Peter Spero, ASSET PROTECTION LEGAL PLANNING, STRATEGIES AND FORMS at Form § 2.08.01 (sample fee agreement).