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WILL THE LAWYERS PAY? COUNSEL'S ETHICAL, CIVIL AND CRIMINAL EXPOSURE FOR CREATING ASSET PROTECTION PLANS

Thomas Moers Mayer, Esq.
Kramer Levin Naftalis & Frankel LLP
New York, New York 10104
Telephone: (212) 715-9169
Facsimile: (212) 715-8000
Tmayer@kramerlevin.com

TABLE OF CONTENTS

Page

WILL THE LAWYERS PAY?
COUNSEL'S ETHICAL, CIVIL AND CRIMINAL EXPOSURE FOR CREATING ASSET PROTECTION PLANS

By Thomas Moers Mayer[1]

I. INTRODUCTION.

Every day the Financial Times prints a newspaper on distinctive pink paper filled with the business events of the world's major economies. Occasionally, the Financial Times prints a special section titled the "Offshore Financial Review." This section is not concerned with the world's major economies. It is instead concerned with those countries which are havens for money fleeing the laws of the world's major economies, including laws requiring the payment of taxes to governments, alimony to spouses, estate distributions to heirs and debts to creditors. The most commonly used shelter from governments, spouses, heirs and creditors is the "offshore asset protection trust".

People establish (or pretend to establish) offshore asset protection trusts for many different reasons (or pretexts). Some people want to move their assets out of politically unstable countries. Some people want to protect income generated by their assets from high taxes. Some people want to shield assets from the competing claims of spouses in divorce proceedings. Some say they want to allocate assets efficiently among heirs without going through expensive and time consuming probate proceedings.

The leading motive for establishing offshore asset protection trusts, however, is to put assets out of reach of creditors. So much is plain from the statements of those who specialize in offshore asset protection trusts:

- Sole purpose asset protection trusts are foreign, offshore trusts created with the sole purpose of defeating the claims of future creditors. Thousands of such trusts currently exist and the implementation of more occurs daily. Such trusts are big business. Driven by professionals and business owners fearful of the U.S. litigation and legislative environment, which they perceive as plaintiff-oriented, unlimited in damage awards, and creditor-friendly, sole purpose asset protection trusts are a growth industry.[2]

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1 Partner. Kramer Levin Naftalis & Frankel LLP. I present this paper in memory of my aunt, Mary Moers Wenig, Professor of Law, Quinnipiac School of Law, and member of the American College of Trust and Estate Counsel for many years.

2 Osborne and Giordani, *Offshore Planning Concepts* in D.E. OSBORNE, 2 ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS Ch. 20 § 20:03, p.5 (Clark Boardman Callaghan 1995) (footnote omitted) (hereinafter "OSBORNE, ASSET PROTECTION"). Major institutions are beginning to sell sole purpose asset protection trusts as a product, complete with forms and recommended trustees:

> Such packages are available from, among others, Credit Suisse in Gibraltar which can be contacted at Suite 110, Neptune House, Marina Bay, Gibraltar and Ernst & Young, which can be contacted in the Channel Islands at Post Office Box 621, Le Gallais Chambers, 54 Bath Street, St. Helier, Jersey JE4 8YD.

Id. at 5 n. 2. Osborne and Giordani's chapter is reprinted in substantial part as *The Preliminary Decisions in Offshore Trust Planning*, 1 J. ASSET PROTECTION No. 6, p. 9, at 12 (July/August 1996).

- Foreign trusts, i.e., trusts that are governed by the laws of foreign jurisdictions, are often used by U.S. citizens or residents to protect assets from creditors.[3]

- The extent of civil liability for negligence among professional persons and those in business and concern about the current cost and availability of professional indemnity insurance have given rise to consideration of foreign-based trusts for the protection of assets.[4]

- As our national litigation epidemic continues to spread, more and more wealthy people are becoming increasingly concerned about the loss of assets to satisfy claims of unknown future creditors. The asset protection trust (APT) is a tool designed by estate planners to respond to this growing problem.[5]

- The off-shore, or foreign situs, trusts are now, in most cases, "tax neutral," offering no significant tax advantages or disadvantages. Nevertheless, off-shore trusts are beginning to be touted by some practitioners as the most foolproof method of asset protection available.[6]

- A foreign trust affords procedural and other barriers which will impact a creditor's decision as to the extent of pursuit of a claim against trust assets.[7]

The prototypical clients for offshore asset protection trusts might include:

- The solvent borrower who has guaranteed his[8] FDIC-insured bank's loan to his currently profitable business and wants to shield some of his assets from future claims under that guaranty (the "Guarantor").

- A wealthy real estate developer with "negative basis" in real estate subject to a non-recourse mortgage due in two years, who will incur massive tax liabilities if he cannot refinance the mortgage[9] and who wants to shield some of his assets from those claims (the "Developer");

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3 P. SPERO, Asset Protection -- LEGAL PLANNING AND STRATEGIES (Warren Gorham Lamont 1994) (footnote omitted) (hereinafter "SPERO, ASSET PROTECTION").

4 M.GRUNDY, J. BRIGGS & J. FIELD, ASSET PROTECTION TRUSTS 1 (2d ed. 1993) (Key Havens Publications PLC) (hereinafter "ASSET PROTECTION TRUSTS").

5 Richard S. Amari, *Asset Protection Trusts: Nuclear Bomb Shelter*, 66 FLA. B.J. 17 (July/August 1992) (footnotes omitted).

6 Mezrich, Jonathan L., *It's Better in the Bahamas: Asset Protection Trusts for the Pennsylvania Lawyer*, 98 DICK. L. REV. 657, 658-59 (1994) (footnote omitted).

7 R. Rudman, *Foreign Situs Trusts*, STRATEGIC PLANNING THROUGH OFFSHORE TRUSTS AND RELATED ASSET PROTECTION TECHNIQUES § XII at XII-2 (Professional Education Systems, Inc. 1997).

8 The masculine pronoun is used to refer to each fraudulent transferor and his counsel. The feminine pronoun is used to refer to each defrauded creditor. The convention is arbitrary. No disrespect is intended by the fact that male malefactors appear more frequently than female victims. *See* G.B. SHAW, ST. JOAN, Scene VI at 119 (Penguin Books).

9 Assume a developer acquires a $25 million building subject to a $20 million mortgage. The developer takes depreciation deductions totaling $10 million, reducing his tax basis in the building to $15 million. Meanwhile, the building doubles in value and the developer refinances with a $40 million non-recourse mortgage. He uses $20 million to repay the old mortgage and spends the other $20 million on personal

- A wealthy doctor who wants a nest egg safe from future malpractice claims (the "Doctor").[10]

Offshore asset protection trusts are particularly attractive to these individual debtors because they both shield assets from creditors and allow the debtors to retain some interest in, and some ability to control and enjoy, the assets themselves. Transfers to spouses, children and friends can also shield assets from the transferor's creditors, but once transferred, the assets are another's property, and the transferor is dependent on the love, affection and/or good will of the transferee to enjoy any benefit from those assets.

This is not the case for assets in a properly constructed offshore asset protection trust. The transferor will retain sufficient power over the trust (such as the power to direct distributions among beneficiaries) to have the transfer to the trust deemed an incomplete gift for tax purposes, thus avoiding the gift tax.[11] Although more control means less protection from creditors, "[t]here is a spectrum of intermediate arrangements" between total control by the grantor and a foreign trustee with complete discretion.[12] The grantor may serve as co-trustee.[13] He may serve on an advisory committee which can advise the trustee regarding management of the trust or even have the power to remove and replace the trustee.[14] One lawyer suggests that

> by retaining the right to change the class of beneficiaries, the grantor can assure that funds can be received through trust distributions to the beneficiaries followed by gifts from trust beneficiaries to the grantor. Also, the grantor can control and manage, and receive compensation from, entities owned by the trust.[15]

Another authority advises that the grantor may retain "the right to beneficial enjoyment."[16] Still another lawyer suggests that another way an offshore trust can be structured:

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necessaries, like a yacht, summer and ski houses, jewelry, clothing, and a securities portfolio. If the mortgagee forecloses, the Internal Revenue Service will deem the building to have been "sold" for the amount of the debt, which yields a "gain" of $25 million ($40 million minus the adjusted tax basis of $15 million) on which the Developer owes taxes (at 20%, the rate applicable in 2002 to long-term capital gains) equal to $5 million.

10 R.F. KLUEGER, A Guide to Asset Protection -- How to Keep What's Legally Yours (John Wiley & Sons, Inc. 1997).

11 E.G. Deleery, *Gifts, Trust and Disclaimers*, OSBORNE, 2 ASSET PROTECTION, *supra* n. 2 at Ch. 14 §§ 14:08, 14:12.

12 Osborne & Giordani, *Offshore Planning Concepts*, *supra* n. 2, Ch. 20 § 20:08 at 12.

13 *Id*., at § 23:10; KLUEGER, *supra* n. 10.

14 Amari, *supra* n. 5, at 22.

15 *Id.*

16 One commonly used device for obtaining asset protection and maintaining benefits is a provision that creates a term during which the beneficiaries are persons other than the settlor. During this term, the settlor has no rights to income or principal. In addition, upon the happening of certain events, this term can be extended. Under this arrangement, the [grantor] has no interest that claimants can reach. The term could coincide with, or at least be sensitive to, the foreign jurisdiction's statute of limitations period. . . . Another option allows the [grantor] to be a beneficiary until the happening of an event that triggers a new class of

is to transfer assets to the trust for a period of years, e.g., ten years, and name the settlor's spouse and children as beneficiaries. After the ten-year period, the trust would lapse, but the trustee would have the discretion to either extend the term of the trust indefinitely if creditors are lurking at the time of the scheduled termination or distribute trust assets to the beneficiaries.

This structure and similar structures are designed to prevent the settlor from ever having an interest in the trust that creditors can seize.[17]

Many of these characteristics would void a trust under American law and make its assets available to the creditors of the transferor.[18]

There is, however, a catch: the creation of an offshore asset protection trust for the explicit purpose of putting assets out of the reach of creditors appears to be a fraudulent transfer.[19] A fraudulent transfer is "voidable" -- that is, the injured creditor may sue the transferee to recover the transfer. Accordingly, there is a debate about the voidability of offshore asset protection trusts that "resonates with more than usual emotion."[20]

Understanding the stakes is critical to understanding the emotion, and the terms of the debate. In the absence of criminal liability, the stakes have nothing to do with the interests of clients. Assets physically located offshore[21] and held in a properly structured offshore asset

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current beneficiaries. For example, if a claimant secures a judgment against the settlor, then the [grantor]'s beneficial interest in the trust automatically becomes either eliminated or the last to be recognized under the terms of the trust, and a new class of beneficiaries is established.

Osborne & Giordani, *The Preliminary Decisions in Offshore Trust Planning*, 1 JOUR. ASSET PROTECTION No. 6, p. 9, 15 (July/August 1996). Note that a provision changing or eliminating the grantor's beneficial interest in the trust upon entry of a judgment, or even the commencement of a bankruptcy, might even be enforceable in a United States bankruptcy proceeding under 11 U.S.C. § 541(c)(2) so long as it was enforceable under "applicable non-bankruptcy law".

17 SPERO, ASSET PROTECTION, *supra* n. 3, at ¶ 7.01[3] at 7-9.

18 *See* RESTATEMENT OF TRUSTS § 156 (1959) ("Where a person creates for his own benefit a trust [including] a provision restraining the voluntary or involuntary transfer of [the transferor's] interest . . . [the transferor's] creditors can reach his interest); A.SCOTT, THE LAW OF TRUSTS § 156 at 1193-96 (3d ed. 1967). *See*, *e.g.*, Security Pacific Bank Washington v. Chang, 80 F.3d 1412, 1415 (9th Cir. 1996) (Hawaiian law follows majority rule that creditors may avoid spendthrift trust established by debtor for his own benefit); *In re* Markmueller, 51 F.3d 775, 776-77 (8th Cir. 1995) (because trust was revocable within five years and transferor retained control over assets, trust was void as against creditors; self-settled trusts are void as against public policy); Johnson v. Commercial Bank, 284 Or. 675, 588 P.2d 1096 (1978).

19 *See* Cioli v. Kenourgios, 59 Cal. App. 690, 695-96, 211 P. 838, 841 (3rd Dist. 1922) (transfer of assets offshore indicates fraud).

20 Osborne & Giordani, *Preliminary Decisions, supra* n. 16, at 12.

21 If the assets are physically located in the United States but nominally owned by an offshore trust whose provisions are offensive to local public policy, a bankruptcy court may ignore the fiction of trust ownership and direct the transfer of the assets into the bankruptcy estate for the benefit of creditors. *See* Marine Midland Bank v. Portnoy (*In re* Portnoy), 201 B.R. 685, 699 (Bankr. S.D.N.Y. 1996) and other cases cited *infra* at n. 127.

protection trust are invulnerable to fraudulent transfer attack. The point is driven home by attorney Robert Klueger[22] in his homily on the heart surgeon Dr. Brown, who was "wise" enough to move all of his assets to an offshore asset protection trust before a patient died on his operating table and he lost a $4.3 million malpractice judgment. We join Dr. Brown's attorney, John Swift, in settlement negotiations with plaintiffs' counsel Mal Gunn:

> "There's one thing I need to tell you right at the start," said Swift. "Dr. Brown has no malpractice insurance."
>
> * * *
>
> "That's okay," said Gunn. "Dr. Brown is a rich man. We'll go after him if we win."
>
> "I don't think so," said Swift. "You see, Dr. Brown doesn't own any assets, either. All the money that Dr. Brown ever made, and all the assets he ever owned, are now owned by a trust."
>
> * * *
>
> "Well," said Gunn, "we'll go after the trust. We'll sue the trustee."
>
> "I don't think so," said Swift. "The trustee of the trust is the Central Pacific Trust Company... located in Rarotonga, on the island of Avarua, in the Cook Islands... in the South Pacific... The Cook Islands is a country that doesn't recognize foreign judgments. If you want to go after the trust's assets, you'll have to sue in the Cook Islands. You'll have to bring all your witnesses over to the island of Avarua. And you won't win, because the Cook Islands has no personal jurisdiction over Dr. Brown."
>
> "I'll get a court order requiring Dr. Brown to turn over the trust's assets," said Gunn...
>
> "It wouldn't do you any good," said Swift. "The Central Pacific Trust Company is under orders to move the assets to some other part of the world if they ever hear of such a court order. We'll move the assets to the Cayman Islands or to the Isle of Man in the Irish Sea. And they will hear of the order. I'll tell them."[23]

If anything, Robert Klueger understates the case: the Cook Islands' own law of fraudulent transfer, clearly drafted by someone with a sense of humor,[24] guarantees that the plaintiffs will never recover anything from the trust.[25] Belize is even worse: Section 7(6)-(7) of the 1992 Trusts Act specifically shields Belizan offshore asset protection trusts from "the claims of creditors in an insolvency" notwithstanding any fraudulent transfer law.[26]

The ability to place assets beyond the reach of a fraudulent conveyance judgment makes off-shore asset protection trusts superior to the asset protection trusts recently established by five

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22 KLUEGER, *supra* n. 10.

23 *Id*. at 8-9.

24 The Cook Islands' International Trust Act (reprinted in ASSET PROTECTION TRUSTS, *supra* n. 4, at Appendix IV) requires a creditor to prove "beyond reasonable doubt" that the trust was established or the transfer made "with principal intent to defraud that creditor", § 13B(1) and that the transfer left the transferor with assets totaling less than claim of the complaining creditor. § 13B(2). In other words, the debtor with $10,000,000 of liabilities and $10,000,000 of assets can transfer $9,000,000 of those assets, and a $1,000,000 creditor cannot, under the law of the Cook Islands, complain. After all, the transferor did retain $1,000,000 -- enough to pay the complaining creditor. The fact that other creditors had claims on the funds, reducing all recoveries to 10¢ on the dollar, is irrelevant.

25 No creditor whose claim arises after a transfer is made to a Cook Islands trust can attack the transfer. *Id.*, Cook Islands' International Trusts Act, at § 13B(4).

26 Reprinted in *Sheltering Assets in 1994*, THOMAS MAYER, REAL ESTATE WORKOUTS AND BANKRUPTCIES 1994, 375, 466 (PLI) and ASSET PROTECTION TRUSTS, at Appendix II.

American states: Missouri in 1986[27], Alaska[28] and Delaware[29] in 1997, Rhode Island[30] and Nevada[31] in 1999. While I have yet to find a reported decision dealing with an attempt to recover a fraudulent conveyance from a domestic asset protection trust, courts have held that assets can be recovered from an ERISA trust.[32] Even in state courts, the state whose creditor has been defrauded tends to hold that its law, not the law of the "property" or holder of the property (i.e., the trust), should govern voidability of the transfer.[33] A fraudulent conveyance judgment can be enforced either against the transferee of the property or the property itself – and property's nominal ownership by an out-of-state trust company will not prevent the entry of an order finding the title voidable and directing its transfer to the creditor.[34] In any event, the domestic statutes have been drafted, as we shall see, to dodge the issue: they do not protect assets transferred into the trust where the transfer was a fraudulent transfer under the law of the state,[35] although Nevada attempts to preclude recoveries from the trust unless the creditor brings an action within a very short period of time.[36]

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27 Until 1986, § 428.010 of the Missouri Revised Statutes provided that any conveyance into a trust for the use of settlor was void against creditor statute provided for the enforcement of spendthrift trusts. Missouri repealed that statute in 1986. *See* Citizens Nat'l Bank v. Cook, 857 S.W.2d 502, 506 (Mo. Ct. App. 1993).

28 AS. § 34.40.110.

29 12 Del. Ch. §§ 3570 *et seq*.

30 R.I. Gen Laws. §§ 18-9.

31 13 Nev. Rev. Stat. §§ 166.010 *et seq*.

32 Shumate v. Patterson, 943 F.2d 362, 365 n.4 (4th Cir. 1991) (creditors can bring fraudulent conveyance action to recovery property transferred into pension plan otherwise protected by ERISA spendthrift provision), *aff'd*, 504 U.S. 753 (1992); *In re* Goldschein, 241 B.R. 370, 379 (Bankr. D. Md. 1999) ("The anti-alienation provision of ERISA and the Internal Revenue Code do not preclude the avoidance of fraudulent transfers."), Tompkins County Trust Co. v. Gowin, 163 Misc. 2d 418, 621 N.Y.S.2d 476 (Sup. Ct. N.Y. County 1994). *See* Smith, *ERISA Qualified Pension Plans as Part of the Bankruptcy Estate*, 212 Cardozo L. Rev. 2119, 2152-57 (2000).

33 Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 81 Cornell L. Rev. 1035, 1076-81 (2000), and particularly James v. Powell, 225 N.E.2d 741 (N.Y. 1967), discussed therein.

34 A bankruptcy court's jurisdiction extends to assets that have been fraudulently transferred. Carlton v. BAWW, Inc., 751 F.2d 781 (5th Cir. 1985).

35 AS § 34.40.110(b)(1) (exempting from protection a transfer "intended in whole or in part to hinder, delay or defraud creditors or other persons under AS 34.40.010"); 12 Del. Ch. §§ 3572(a) (trusts are subject to UFTA as enacted in Delaware); R.I. Gen. Laws § 18-9.2-4 ; 13 Nev. Rev. Stat. § 166.170; Missouri Rev. Stat. § 456.080.3.

36 Creditors with claims existing as of the date of the trust must bring actions within two years of the transfer or within six months of when they discover or reasonably should have discovered the transfer, whichever is later. Creditors with claims arising after the transfer must sue within two years of the transfer, irrespective of when they discover or should have discovered the transfer. 13 Nev. Rev. Stat. § 166.170.

For the reasons set forth above, many if not most asset protection lawyers conclude that foreign asset protection trusts are superior: once the assets are abroad, it is difficult if not impossible to recover them through the American courts.[37]

Where the debtor's assets are not available, the next logical target for the creditor is the person who set up the fraudulent transfer scheme to begin with: the lawyer. If the offshore asset protection trust is a fraudulent transfer, it may be unethical and subject the lawyer to sanctions, including disbarment. If the offshore asset protection trust is a fraudulent transfer, the lawyer is the logical deep pocket to sue - especially since litigation against the client is likely to develop a detailed record as to the lawyer's role and responsibility for the transfer.[38]

The asset protection bar is well aware of its exposure.[39] It has even persuaded Delaware, in its domestic asset protection trust law, to exculpate from liability "any person involved in the counseling, preparation, execution or funding of" a Delaware asset protection trust,[40] although this writer is unable to comprehend why anyone thinks such exculpation is effective in a suit brought under non-Delaware law.[41]

Accordingly, lawyers who set up offshore asset protection trusts have argued that transfers to such trusts are *not* fraudulent transfers so long as:

- the transferor is solvent,
- his current creditors are provided for, and
- he does not expect to incur other or future debt beyond his ability to pay.

The asset protection bar concludes that the lawyer who limits his clients to those seeking to shield assets from unknown *future* creditors has no ethical, civil or criminal exposure.[42]

Note that the Guarantor, Developer and Doctor each fit some or all of the asset protection bar's criteria. Each is wildly solvent. Each can easily pay his existing creditors. Each is concerned only that events in the future may give rise to claims he does not wish to pay. The asset protection bar believes that some or all of these clients may appropriately use offshore asset protection trusts to shield their assets from their future creditors.

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37 Brown & Cushing, *Understanding "Estate Planning": Asset Protection or Fraudulent Conveyance*, 16 J. AMERICAN ACADEMY OF MATRIMONIAL LAWYERS 347, 361-62 (2000); Lee, *Piercing Offshore Asset Protection Trusts in the Cayman Islands: the Creditors' View*, 11 TRANSNAT. L. 463, 468 (1998).

38 Siegel, *Attorney Liability: Is This The New Twilight Zone?*, 27 U.MEMPHIS L. REV. 13, 15-16 (1996).

39 *See, e.g.*, KLUEGER, *supra* n. 10, at 215.

40 12 Del. Ch. § 3572(d).

41 Could Delaware pass a law exculpating its citizens from liability under the tort laws of other states?

42 *See, e.g.*, Kruse, *Fraudulent Transfers* in 1 ASSET PROTECTION (OSBORNE, ED.), *supra* n. 2, Ch. 2 § 2:21; KLUEGER, *supra* n. 10; Engel, *When is a Subsequent Creditor not a Subsequent Creditor?*, 3 J. INT'L TR. & CORP. PLANNING No. 2 at 114 (1994); Osborne & Giordani, *Preliminary Decisions, supra* n. 16, at 11.

I believe the asset protection bar is wrong. Part II argues that offshore asset protection trusts *are and should be* fraudulent transfers even if aimed only at future creditors.

What follows from this, however, is not clear.

Part III examines the following conundrums:

A lawyer cannot ethically assist a fraudulent transfer, but not because it is a "fraud"; the judicial decisions and ethics opinions find instead that it is "illegal" or "dishonest". However, other decisions have held that the attorney-client privilege does not shield communications relating to a fraudulent transfer because it *is* a fraud. At bottom, there is no agreement as to what a fraudulent transfer is. Is it a fraud? A species of conversion? Is it a tort at all? If it is a tort, why do a plurality of jurisdictions -- even those that impose civil liability for conspiracy or aiding and abetting tortious conduct -- hold that there is no cause of action for either aiding and abetting a fraudulent transfer or for conspiracy to commit a fraudulent transfer? If a fraudulent transfer is not a "wrong", why is it unethical to assist it? And how can one reconcile decisions denying that it is a "tort" with federal and state statutes holding that it is criminal?

Part IV applies the analysis of Part III to the hypothetical clients. Part V concludes with the author's own views on what the law should be.

II. IS THE CLIENT DOING WRONG? FRAUDULENT TRANSFERS AND SUBSEQUENT CREDITORS.

A. The Laws and their Origins.

Three statutes govern fraudulent transfers:

- the 1571 Statute of Elizabeth,
- the 1918 Uniform Fraudulent Conveyance Act, and
- the 1984 Uniform Fraudulent Transfer Act.

I make no apologies for setting forth such well known statutes in full, or for exploring their archaic origins. A close reading of both text and origins are directly relevant to the validity of offshore asset protection trusts.

1. The Statute of Elizabeth and its Origins.

"Our notion of the fraudulent conveyance," states Professor Glenn in his leading[43] (and beautifully written) treatise, "traces to a [1571] statute of Elizabeth . . . commonly called the Statute of Fraudulent Conveyances",[44] not because it was the first statute on the subject but because it was written up by Sir Edward Coke and "later, no one cared to go back further."[45]

But Professor Glenn does go back further, and to great effect. Before the Statute of Elizabeth, there was legislation with respect to "sanctuaries" -- areas of England in which the Crown's writ could not enter and where debtors could live free from execution by their creditors.

> [T]he association of sanctuary with fraudulent conveyance appeared on the face of . . . medieval legislation . . . . In these statutes Parliament recited the common practice by which a debtor would transfer his assets to some friend but in trust for the debtor; and, that accomplished, the rascal would take himself to sanctuary and there "live a great time with high countenance" until his creditors, being unable to reach the property which was held in trust for the debtor, would compromise their claims at a low figure, whereupon the delinquent would resume the ordinary course of life, and doubtless run up more bills.[46]

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43 G. GLENN, I FRAUDULENT CONVEYANCES AND PREFERENCES § 58 p. 79 (Rev. Ed. 1940). The United States Supreme Court relied heavily on Glenn's treatise in Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 44 (1989) to the annoyance of the dissent: "[N]otwithstanding his scholarly eminence, Professor Glenn's view of what the 18th-century English equity courts would have done with an action such as this one is not dispositive." *Id*. at 85 (White, J., dissenting).

44 13 Eliz. c. 5 (1571).

45 GLENN, *supra* n. 43, at §§ 59-61, traces fraudulent conveyances back to a 1477 common law case, a 1376 statute of Edward III and Roman Law before that.

46 *Id.,* § 61 at 84-85.

Such medieval behavior is strikingly similar to today's offshore asset protection trusts.

The medieval statutes which recited and condemned such behavior were enacted to make the debtor's lands and goods liable to his creditor's execution, despite the previous transfer.[47] The Statute of Elizabeth broadened the concept of the laws against sanctuary by voiding fraudulent transfers even if the debtors did not take sanctuary.[48]

State courts adopted the Statute of Elizabeth into state common law, and it remains authority, as the forerunner of common law or the basis for various statutes, even today.[49] In relevant part, the statute reads as follows:[50]

> An Act against Fraudulent Deeds, Alienations, etc. 13 Eliz. c. 5
>
> I. For the avoiding and abolishing of feigned, covinous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions, as well of lands and tenements as of goods and chattels, more commonly used and practiced in these days than hath been seen or heard of heretofore: which feoffments, gifts, grants [etc., . . .] have been and are devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose, and intent to delay, hinder or defraud creditors *and others* [emphasis added] of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs, not only to the let or hindrance of the due course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued;
>
> II. Be it therefore declared, ordained, and enacted by the authority of this present Parliament, that all and every feoffment, gift, grant, [etc., . .] at any time had or made sithence the beginning of the Queen's Majesty's reign that now is, or at any time hereafter to be made to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators, *and assigns*,[51] [emphasis added] and every of them, whose actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries and reliefs, by such guileful, covinous, or fraudulent devices and practices, as is aforesaid, are, shall or might be in anywise disturbed, hindered, delayed or defrauded) to be clearly and utterly void, frustrate, and of none effect; any pretence, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.

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47 *Id.*

48 *Id.*, § 61 at 85.

49 *In re* Southern Carolina Knitters, 2003 U.S. App. LEXIS 618 (Jan. 16, 2003) (South Carolina law based on Statute of Elizabeth); Broadfoot v. Hunerwardel (*In re* Duloch), 282 B.R. 54 (Bankr. N.D. Ga. 2002) (Georgia law based on Statute of Elizabeth). The Statute of Elizabeth governed fraudulent conveyances in North Carolina until it was repealed by the enactment of the Uniform Fraudulent Transfer Act in 1997. I am indebted to Guy Clerici of Van Winkle, Buck, Wall, Starnes and Davis for bringing this fact to my attention.

50 The Statute of Elizabeth is set forth in full in 2 GLENN, *supra* n. 43, Appendix at 1069-72.

51 Note that an action under the Statute of Elizabeth was assignable -- which means it is not an "equitable remedy", since such remedies are personal to the plaintiff invoking them and cannot be transferred to a third party.

> III. And be it further enacted by the authority aforesaid, that all and every the parties to such feigned, covinous, or fraudulent feoffment, gift, grant, [etc., . .] before expressed, and being privy and knowing of the same, or any of them, which at any time after the tenth day of June next coming shall wittingly and willingly put in ure, avow, maintain, justify or defend the same, or any of them, as true, simple, and done, had, or made, bona fide and upon good consideration; or shall alien or assign any of the lands, tenements, goods, leases or other things before mentioned, to him or them conveyed as is aforesaid, or any part thereof, shall incur the penalty and forfeiture of one year's value of the said lands, tenements, and hereditaments, leases, rents, commons, or other profits of or out of the same; and the whole value of the said goods and chattels; and also so much money as are or shall be contained in any such covinous and feigned bond, *the one moiety whereof to be the Queen's Majesty*,[52] [emphasis added] her heirs and successors, and the other moiety to the party or parties grieved by such feigned and fraudulent feoffment, gift, grant, [etc., . .] and other things aforesaid, to be recovered in any of the Queen's courts of record, by action of debt, bill, plaint or information, wherein no essoin, protection or wager of law shall be admitted for the defendant or defendants; and also being thereof lawfully convicted *shall suffer imprisonment for one-half year without bail or mainprise*. [Emphasis added.]

Several elements of the text are worthy of notice. First, Section I condemns conveyances made with "intent to hinder, delay or defraud creditors *and others*". Thus, at its inception, fraudulent transfer law condemned intentionally fraudulent transfers without specifying that existing creditors had to be injured:

> The word 'others' is inserted to take in all manner of persons as well creditors, after as before the conveyance whose debts should be defrauded. The enacting clause is still stronger because the word "creditors" is not mentioned, but general words "person or persons." The words of the statute seem to be so general in order to take in all persons who shall be any ways hindered.[53]

Second, it is worth noting (for reasons that will appear in Part III.C, below) that Section II of the Statute of Elizabeth made liable "*all and every the parties to such feigned, covinous, or fraudulent feoffment, gift, grant,* [etc., . . .] *before expressed, and being privy and knowing of the same*. . . ." Thus, at least in the beginning, third parties could be liable for aiding and abetting a fraudulent transfer, or conspiracy to commit a fraudulent transfer.

Third, it is worth noting that the Statute of Elizabeth was a *penal* statute -- that is, it made fraudulent transfers a crime against the state.[54] It was only later that the Statute was read

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52 Professor Glenn believes that the 1571 Statute on Fraudulent Conveyances attracted more attention than the 1571 Bankruptcy Act because the Statute on Fraudulent Conveyances was a revenue-producing measure for the Crown. GLENN, *supra* n. 43, at § 61c, at 93.

53 O. BUMP, FRAUDULENT CONVEYANCES 321 (1872) (footnote omitted).

54 Professor Glenn's language is too good not to quote:

> It is remarkable that, although the Statute of Fraudulent Conveyances is always associated with Twyne's Case, and Coke's reading upon it, two important features of both statute and decision are always ignored. Yet the facts are there in cold print. In 1600 or thereabouts, Pierce, a Hampshire farmer, sold sheep to Twyne, who did not drive them away, as naturally he should have done. After the lapse of a considerable period, during which Pierce had shorn the sheep and marked them as his own, a judgment creditor of Pierce attempted to levy on the sheep. Thereupon Pierce's friend, Twyne, appeared and forbade the banns, asserting that the sheep were his; and he was backed up by his following, who, perhaps, were not unwilling to resist authority in a good cause. . . . [L]et us see how the case was brought into court. There was not action for a "rescue", nor even a warrant for disorderly conduct; but rather, there was a prosecution in that most formidable of courts, the Star Chamber. And, "by the judgment of the whole court", as Coke tells us, "Twyne was convicted of fraud, and he and all the others of a riot." As respectable judges composed part,

to be declarative of even earlier common law principles giving a judgment creditor a right to execute on property fraudulently transferred to a grantee.[55]

The Statute of Elizabeth is inseparably entwined with *Twyne's Case* thirty years later,[56] in which the Star Chamber condemned as fraudulent Twyne's buying sheep from his friend Pierce while leaving them in Pierce's possession. In deciding that sheep nominally owned by Twyne were really Pierce's and subject to Pierce's creditors, the Star Chamber held that intent to defraud creditors could be shown through certain "badges of fraud", an analysis which evaluates facts such as whether the transferor has:

(1) transferred all or substantially all of his property;

(2) retained possession of the property, although title may exist in another entity;

(3) consummated the transfer in secret;

(4) a trust relationship with the person to whom the property is conveyed;

(5) an actual or pending suit against it at the time of the transfer;

(6) drafted the instrument effecting the transfer to suspiciously state that the transfer is in fact bona fide;

(7) received adequate consideration for the transfer; and

(8) made a gift to a family member.

As badge (5) shows, the English common law suspected that trusts were used to shelter assets from creditors, and condemned that shelter. The prejudice against trusts survives today in the general American rule that a spendthrift trust is void against creditors of the grantor if the grantor is also the beneficiary.[57]

> at any rate, of the Court as it sat that day, we are justified in repeating the question which doubtless the Hampshire people put to their own counsel, why make a State trial out of private knavery?
>
> The answer is that the Statute of Fraudulent Conveyances was intended as a State measure, for the uses of the Crown . . . . [I]n every case of a fraudulent conveyance, one half the value of the property transferred should belong to the Crown, with the other half to the parties aggrieved; and that the guilty debtor should "suffer imprisonment for one half year, without bail or mainprize."

GLENN, *supra* n. 43, at § 61a at 86-87 & § 61b at 89.

55 *Id.*, at § 61 at 85 & n. 21; § 61e at 96.

56 *Twyne's Case*, Mich. 44 Eliz., 3 Coke Rep. 80b (Star Chamber 1601).

57 *But see* BUMP, *supra* n. 53 at 330:

> The simple inquiry is whether the property belongs to the debtor, not upon any theory of fraud and against the terms of the conveyance, but upon a theory of equitable title reserved to the grantor by the very terms of the conveyance, which transfers the legal and nominal title to another.

2. The Uniform Fraudulent Conveyance Act.

The next general advance in the enactment of laws against fraudulent transfers occurred in 1918, with the approval of the National Conference of Commissioners on Uniform State Laws and the American Bar Association of the Uniform Fraudulent Conveyance Act ("UFCA"). The UFCA was enacted as law in 25 jurisdictions, including the Virgin Islands[58] and as of June 2001 remained in force in five jurisdictions: Maryland, New York, Tennessee, the Virgin Islands and Wyoming. The UFCA reads, in relevant part (and with critical phrases italicized), as follows:

§ 1. Definition of Terms

* * *

"Creditor" is a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

§ 4. Conveyance by Insolvent

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.

§ 5. Conveyances by Persons in Business

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.

§ 6. Conveyances by a Person About to Incur Debts

Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, *is fraudulent as to both present and future creditors*.

§ 7. Conveyances Made With Intent to Defraud.

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*.

The italicized passages provoke several observations.

(a) Present and Future Creditors.

UFCA § 4 provides that conveyances by insolvents are fraudulent only with respect to "creditors" -- i.e., those who hold claims *at the time of the transfer*. However, each of

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Id.

[58] 7A Uniform Laws Annotated (Business and Financial Laws) 639 (1985) (hereinafter "ULA").

the following sections provide that *persons other than "creditors"* may void a conveyance. UFCA § 5 allows "creditors and other persons who become creditors during the continuance of [the debtor's] business" to void conveyances which left the debtor with unreasonably small capital for that business. UFCA § 6 allows "present and future creditors" to void conveyances by a debtor about to incur debts beyond his ability to pay. Finally, UFCA § 7 provides that either present or future creditors can void conveyances made with actual intent to hinder delay or defraud.

"Creditor" is defined broadly to include the holder of "any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent". It follows that UFCA § 5's "person who becomes a creditor" or the "future creditor" of UFCA §§ 6 and 7 must be a person who had no claim at all at the time of the conveyance.

(b) Incurrence of Debts: Intent and Belief.

UFCA § 6 voids conveyances by a debtor who intends or believes that he *will* incur debts beyond his ability to pay. It does not void conveyances by a debtor who intends or believes that he *may* incur debts beyond his ability to pay. Thus a conveyance made to an offshore asset protection trust should not be voidable merely because it is *possible* the debtor will incur debts beyond his ability to pay. It is not clear whether such a conveyance is voidable under UFCA § 6 if the debtor believes it is *probable* that he will incur debts beyond his ability to pay. There is no reported case on this question.

(c) Intent to Defraud Future Creditors.

We have already seen that future creditors have *standing* to void conveyances made with actual intent under UFCA § 7, but the statute goes further: it specifically condemns the intent to hinder, delay and defraud future (in addition to present) creditors. In other words, even if no creditors present at the time of the conveyance were defrauded, a conveyance which is intended to hinder, delay or defraud only future creditors can be avoided.

3. The Uniform Fraudulent Transfer Act.

In 1979, hard upon Congress' 1978 enactment of the new Federal Bankruptcy Code, the National Conference of Commissioners on Uniform State Laws appointed a committee to review and revise the UFCA. The committee's labors produced the Uniform Fraudulent Transfer Act ("UFTA"), which the Conference approved in 1985 and which was, as of 1996, enacted in the District of Columbia and 39 states -- all except the five UFCA states and seven states who have not adopted any uniform statute.[59]

The UFTA reads in relevant part as follows:

§ 1. Definitions.

* * *

59 The seven non-uniform states are: Alaska, Georgia, Louisiana, Kentucky, Mississippi, South Carolina, and Virginia.

(3) "Claim" means 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.

(4) "Creditor" means a person who has a claim.

§ 4. Transfers Fraudulent as to Present and Future Creditors.

(a) 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; 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 the 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.

(b) In determining actual intent under subsection (a)(1), consideration may be given, *among other factors*, to whether:

(1) the transfer or obligation was to an *insider*;

(2) *the debtor retained possession or control of the property transferred after the transfer*;

(3) the transfer or obligation was disclosed or concealed;

(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) the transfer was of substantially all of the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed assets;

(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) the transfer was occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

§ 5. Transfers Fraudulent as to Present Creditors.

> (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.
>
> (b) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

When used to measure the propriety of offshore asset protection trusts, the UFTA differs from the UFCA -- probably by accident -- in several interesting ways.

First, although the UFTA follows the UFCA in allowing future creditors to challenge transfers made with actual intent to hinder, delay and defraud, UFTA § 4(a)(1) only condemns actual intent to hinder delay and defraud "creditors" -- not "future creditors". As shown above, a conveyance made with actual intent to hinder, delay or defraud future creditors is voidable under the UFCA. The UFTA is not so clear, although there is no indication in the Official Comment to the UFTA that the National Conference of Commissioners on Uniform State Laws intended to change several hundred years of statutory and common law proscription of fraudulent intent as to future creditors.

Second, UFTA § 4(a)(2)(ii) voids gratuitous transfers if made when the debtor intended "to incur *or reasonably should have believed* that he [or she] *would* incur" debts beyond his [or her] ability to pay. The reference to "reasonable belief" that debts "would" incur indicates that the probability of incurrence is now important. As noted above, the UFCA focused only on the debtor's *actual* belief that debts *will* be incurred, without regard to the probability that such debts would be incurred.

Third, unlike UFCA § 7, which merely condemns "actual intent to hinder, delay and defraud" and left to the courts the task of divining intent, UFTA § 4(b) follows *Twyne's Case* by enumerating "badges of fraud" (including many taken from *Twyne's Case*) weighing for or against a finding of intent to hinder, delay or defraud.

Only factor (1), which refers to transfers to an "insider" (and you have to dig to find out that a "trust" can be an insider),[60] and factor (2) (the retention of control by the debtor over assets in the trust) appear to be relevant to measuring the intent behind creation of an

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60 UFTA § 1(7) defines "insider" as "including" various persons and entities, much like the Bankruptcy Code. It does not "include" trusts within its terms. However, Comment (7) indicates that a trust can be an insider:

> As in the Bankruptcy Code . . . the word "includes" is not limiting, however. Thus, a court may find a person living with an individual for an extended time in the same household or as a permanent companion to have the kind of close relationship intended to be covered by the term "insider." *Likewise, a trust may be found to be an insider of a beneficiary.*

(Emphasis added.)

offshore asset protection trust. There will be no concealment (factors 3 and 7): the debtor must report the trust on his tax returns. There will be no absconding (factor 6): most American debtors will establish an asset protection trust to allow them to live in the United States while their assets are safe somewhere else. The balance of the factors are duplicative of the substantive elements of "constructive fraud" in UFTA §§ 4(a)(2) and 5(a). Although the Statute of Elizabeth had made the use of a trust a "badge of fraud", the UFTA refrains from doing so -- a deliberate omission, according to UFTA § 4 Comment (5):

> The second, third, fourth, and fifth factors listed are all adapted from the classic catalogue of badges of fraud provided by Lord Coke in Twyne's Case [citation omitted]. Lord Coke also included the use of a trust and the recitation in the instrument of transfer that it "was made honestly, truly and bona fide," but the use of the trust is fraudulent only when accompanied by elements or badges specified in this Act, and recitals of "good faith can no longer be regarded as significant evidence of a fraudulent intent."[61]

Note, however, that such factors are not exclusive. UFTA § 4(b)'s introductory clause states only that in determining actual intent, "consideration *may* be given, *among other factors*", to those enumerated in § 4(b).

B. Applying the Statutes to the Clients.

Now let us return to our three hypothetical clients for an offshore asset protection trust: the Guarantor, the Developer and the Doctor.

The Developer is worried about the IRS, to whom he does not yet owe any money and the Doctor is worried about a malpractice suit from a patient he has not yet even met. The IRS and the patient are clearly "those who become creditors" during the Developer's and Doctor's respective "businesses" or "future creditors"; they can void conveyances only under UFCA §§ 5, 6 and 7 and under UFTA §§ 4(a)(i)&(ii).

The Guarantor has already guaranteed his business' loan from his FDIC-insured bank. Accordingly, the bank (or the FDIC, if the bank fails) is a "present creditor" and can void a transfer under any of UFCA §§ 4, 5, 6 or 7, and under UFTA §§ 4(a)(i)&(ii) & 5(a). However, the Guarantor is not insolvent and will not be rendered insolvent by the planned transfer to the trust. Thus UFCA § 4 and UFTA § 5(a) do not apply to his planned transfers. The Guarantor is not "in business"; his corporation is. Thus his transfer cannot be said to leave him with "unreasonably small capital" for the conduct of business,[62] and he cannot be said to incur additional debts merely because his corporation does so. Accordingly, neither UFCA §§ 5&6 nor UFTA §§ 4(a)(2)(i)&(ii) would apply. It follows that the Guarantor's conveyances can be attacked only by a showing of "intentional fraud" under UFCA § 7 or UFTA § 4(a)(1).

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61 ULA, *supra* n. 58, at 654.

62 *See* Finger v. Kemp, 112 N.J. Eq. 14, 15, 163 A. 153, 153 (N.J. Ch. 1932) (gratuitous conveyances by partners of their own property to their wives did not impair partnership's capital and thus was not fraudulent under Section 5); Matter of Atkinson, 63 B.R. 266, 269 (Bankr. W.D. Wis. 1986) (gratuitous conveyance by mother, guarantor of son's business, not voidable under Section 5 because she was not in business).

In sum, the propriety of offshore asset protection trusts for all three clients rests on a determination of whether they transfer assets to their trusts with "actual intent to hinder delay and defraud" under UFCA § 7 and UFTA § 4(a). We turn now to the asset protection bar's attempt to prove that the creation of offshore asset protection trusts with the sole purpose of shielding assets from future creditors does not constitute "actual intent to hinder, delay or defraud."

C. <u>The Case for Offshore Asset Protection Trusts</u>.

Barry Engel is a leading defender of offshore asset protection trusts.[63] I know he takes his ethical obligations very seriously because I have seen his firm turn down a client who did not meet his standards. He has argued in various journals that a solvent grantor commits no fraudulent transfer when he establishes an offshore asset protection trust to shield assets against unknown future creditors. Mr. Engel's argument, elegantly set forth in articles over a two year span,[64] may be summarized as follows:

1. The UFCA and UFTA do appear to condemn transfers made with actual intent to hinder, delay and defraud future creditors.

2. However, there is authority that not all creditors arising in the future will qualify as "future creditors" under the UFCA and UFTA.

3. In particular, the Nebraska Supreme Court in *First National Bank v. Bunn* held that a future creditor cannot attack a 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*."[65] (Emphasis added by Engel).

4. Furthermore, *Hemphill Co. v. Davis Knitting Co.*[66] established the "Pennsylvania rule" that with respect to subsequent creditors, a gratuitous transfer is "bad only as

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63 Mr. Engel, a principal in the law firm of Engel Reiman & Lockwood PC in Denver, Colorado is, *inter alia*,

- the President, a Senator ex-officio, and a Fellow of the Isle of Man-based Offshore Institute,
- the consulting editor of SHORE TO SHORE,
- a member of the International Bureau of London-based OFFSHORE INVESTMENT magazine, and
- a member of the Editorial Board of London-based TRUSTS & TRUSTEES AND INTERNATIONAL ASSET MANAGEMENT, and
- a member of the Board of Advisors of Warren, Gorham & Lamont's JOURNAL OF ASSET PROTECTION.

64 Engel, *Subsequent Creditor*, *supra* n. 42, at 105-16 (1994); Engel, *Sole Purpose Asset Protection Planning, or, Do I Really Need Independent Reasons To Protect My Estate?*, OFFSHORE INVESTMENT: JOURNAL FOR THE OFFSHORE INSTITUTE No. 28 at 48-50 (July/Aug. 1992).

65 195 Neb. 829, 832, 241 N.W.2d 127, 129 (1976). *See also* Jayne v. Hymer, 66 Neb. 785, 92 N.W. 1019, 1020 (1902) (future creditor protesting transfer as fraudulent must show that transferor expected to become indebted to creditor and made transfer to hinder or delay the collection of the debt when it should be contracted).

66 114 Pa. Super. 94, 173 A. 704, 706 (1934).

to those it was intended to defraud [Mr. Engel later cites *Roland v. United States*[67] for the same point]. . . . [S]ubsequent creditors can avoid the sale only under special circumstances; as, for instance, by showing that it was made with a view to incurring liabilities, or to provide against the contingencies of a hazardous business, which gave rise to their debts . . . ."[68] Mr. Engel concludes that real estate development, e.g., is not a "hazardous business"; otherwise "most business people and professionals could be said to be engaging in hazardous endeavors."[69]

5. Mr. Engel finds "particularly compelling" the case of *Hurlbert v. Shackleton*[70] under the UFCA, where Dr. Shackleton lost his malpractice insurance and transferred his assets to his wife in 1983, committed malpractice in 1984 and was sued in 1985. Shackleton testified that he transferred assets to his wife "[b]ecause I wasn't able to get malpractice insurance, and I wanted to cover all the bases." The trial court had dismissed the fraudulent transfer action. The appeal court reversed and remanded on the ground that the trial court had failed to determine whether or not Dr. Shackleton harbored actual fraudulent intent at the time of the transfers. Mr. Engel reasons that if Dr. Shackleton's assets were per se fraudulent, the court would not have remanded but reversed and held in favor of the plaintiff. He then quotes at length the dissent in *Hurlbert* to the effect that Shackleton could not have intended to defraud Hurlbert, who was an unknown and unintended creditor.

6. Mr. Engel concludes by citing several cases where transferors gave assets to family members to hide from future creditors, and then (when the future creditors were paid, settled or did not materialize) sought to recover such assets from their relatives. Each case cites the rule that such transfers will not be reversed if made to hinder, delay and defraud creditors, but then held for the transferor anyway by finding that a transfer of assets away from future creditors was not a fraudulent transfer and thus the rule did not apply.

Perhaps an even better case, not cited by Mr. Engel, is *In the Matter of Joseph Heller Inter Vivos Trust*,[71] where the trust held both an apartment building and liquid assets and the trustee was allowed to sever the trust into two trusts, with one to hold the building and the other to hold all other property for the explicit purpose of shielding it from creditors. The Surrogate interpreted New York's Estate Powers and Trusts Law as permitting transfers to trusts so long as they did not defraud "*existing creditors*". The Surrogate also noted that a beneficiary of a trust can, under New York law, renounce its interest to avoid having it be seized

67 838 F.2d 1400, 1402 (5th Cir. 1988).

68 Hemphill Co. v. Davis Knitting Co., 114 Pa. Super. at 98.

69 Engel, *Subsequent Creditor*, *supra* n. 42 at 19.

70 560 So. 2d 1276 (Fla. Ct. App. 1990).

71 161 Misc. 2d 369, 613 N.Y.S.2d 809 (Sur. Ct. 1994).

by creditors, and concluded: "Clearly, if New York law allows a beneficiary to defeat existing creditors by a renunciation, a trust can be severed for the purpose of limiting liability to non-existent, but possible, future creditors."[72]

7. Mr. Engel concludes that "asset protection planning may result in a future potential creditor being unpaid. But this, you conclude, does not necessarily mean that transfers made in the course thereof are made with actual fraudulent intent as to subsequent creditors."

There is other authority that buttresses Mr. Engel's point. In *Lynch v. La Fonte*,[73] the court held that gratuitous transfers made in 1935 by a debtor not in business at that time were not made with intent to defraud creditors with claims arising in 1937:

> It would be a dangerous doctrine which would permit a trustee in bankruptcy to go back over the years and set aside gifts made by the bankrupt at a time when he was perfectly solvent and had no creditors, in order to impress a trust upon property conveyed under such circumstances. Few individuals can anticipate the future.[74]

In 1997, John E Sullivan III, a debtor-creditor lawyer, entered the lists on the side of the asset protection bar,[75] conceding that the UFTA appeared to bar all forms of asset protection planning,[76] Mr. Sullivan argued that not all creditors are protected by the UFTA:

> It is well established under recognized legal theories that individuals may not strip themselves of assets in an intentional, reckless, or even negligent disregard of likely claimants. Beyond this important limit, however, it is correct to state the planning to protect assets from future lawsuits is not inherently fraudulent but is actually perfectly legitimate . . . . Put simply, (under the UFTA) not all plaintiffs hold "claims" and those who lack "claims" cannot invoke UFTA.

Mr. Sullivan argued in particular that a transfer could not be fraudulent if made with intent to hinder delay and defraud only creditors whose claims arose under legislation enacted

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72 *Id*., 161 Misc. 2d at 371, 613 N.Y.S.2d at 810-11.

73 37 F. Supp. 499 (S.D. Cal. 1941).

74 *Id*. at 505. *See also* Cram v. Cram, 262 Mass. 509, 512, 160 N.E. 337, 339 (1928): "Where . . . one substantially free from debt transfers property to or for the benefit of his wife or family, so that it shall not be exposed to the hazards of future business or be subjected to the risks of improvidence, this is not fraudulent as to subsequent creditors. The same principal applies where one who, although having some debts, still is possessed of estate largely in excess of existing obligations, transfers, such excess of property with that purpose. In order that such transfer may be set aside or be tainted with fraud, it must further appear expressly or impliedly that there was an intent on the part of the transferrer to contract debts in the future and avoid payment of them because of the transfer of his property."

75 Sullivan, *Future Creditors and Fraudulent Transfers: When A Claimant Doesn't Have A Claim, When a Transfer Isn't A Transfer, When Fraud Doesn't Stay Fraudulent and Other Important Limits to Fraudulent Transfer Laws for the Asset Protection Planner*, 22 DEL. CORP. J. L. 955 (1997). Mr. Sullivan identifies himself as concentrating in "debtor-creditor matters (including bankruptcy, collections and asset protection planning).

76 *Id*. at 974-75.

after the transfer, citing in support decisions by the Second Circuit's decision in the first *LTV*[77] case and the Third Circuit in *Penn Central*.[78] Those courts held that claims arising under statutes passed after the commencement of their respective bankruptcies were not "claims".

He also argued that transfers intended to preserve assets against creditors whose claims arise out of "attenuated" assertions of liability were not fraudulent, citing in support the decisions in *Piper Aircraft.*[79] Piper Aircraft manufactured planes which had an average life of 26 years. Occasionally the planes crashed, and the estates of the pilots and passengers would often sue, alleging that a product with an average life of approximately 25 years had a "design defect."[80] The product liability lawsuits had driven Piper into bankruptcy, and Piper tried to design a plan that would prevent the victims of future crashes from suing after the bankruptcy plan was confirmed. The bankruptcy court, district court and Eleventh Circuit held that the bankruptcy court could not appoint a representative for future victims of Piper Aircraft crashes to bind such victims as creditors under Piper's chapter 11 plan. The courts were troubled by the specter of an unborn baby, crashing years after the bankruptcy, being bound by the chapter 11 plan.[81] The courts held that the relationship between the pre-confirmation acts of Piper, and the possible future claim of a plaintiff yet unborn, were "too attenuated" to be bound by the plan.[82]

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77 *In re* Chateaugay Corp., 53 F.3d 478, 497 (2d Cir. 1995).

78 *In re* Penn Cent. Transp. Co., 944 F.2d 164 (3d Cir. 1991).

79 *In re* Piper Aircraft Corp., 162 B.R. 619 (Bankr. S.D. Fla.), *aff'd sub nom.* Epstein v. Official Committee of Unsecured Creditors (*In re* Piper Aircraft Corp.), 58 F.3d 1573 (11th Cir. 1995).

80 The writer represented a potential acquiror of Piper Aircraft and was briefed in detail on the product liability profile of the airplanes manufactured by the debtor. Common sense and the English language would not normally allow the conclusion that a product with an average life of 26 years has a "design defect". In addition, the "wealth shifting" effects of product liability lawsuits, so beloved of academic supporters of the tort system, were extremely perverse, since the crash victims tended to be prosperous professionals who could afford planes and those who paid the price of the lawsuits turned out to be the laid-off hourly workers at the airplane manufacturer. Congress finally enacted a "statute of repose" that prevents any victim of an airplane crash to sue for a design defect if the plane was manufactured more than 17 years before the crash.

81 *In re* Piper Aircraft, 168 B.R. 434, 438 (S.D. Fla. 1994), *aff'd sub nom.*, Epstein v. Official Committee of Unsecured Creditors (*In re* Piper Aircraft Corp.), 58 F.3d 1573 (11th Cir. 1995).

82 *In re* Piper Aircraft Corp., 168 B.R. 434 at 440.

Mr. Sullivan also suggests, *supra* n. 75, at 1034-40, that the transfer of assets into an asset protection trust may not even be a "transfer" under the UFTA, *citing* the bankruptcy court decision in *In re* Levine, 139 B.R. 551 (Bankr. M.D. Fla. 1992). Levine had converted property that was subject to creditor claims into property that was exempt from creditor claims, and the bankruptcy court held the conversion was not a transfer. Mr. Sullivan's argument, and his reliance on *Levine*, is without merit: the Eleventh Circuit reversed the bankruptcy court decision in 1998, *In re* Levine, 134 F.3rd 1046 (11th Cir. 1998), and numerous cases have held that a conversion of non-exempt to exempt assets is a transfer under the fraudulent conveyance laws. *See In re* Smiley, 864 F.2d 562, 565 (7th Cir. 1989); Royal v. Baker (*In re* Baker), No. 01-20281, 2002 Bankr. LEXIS 130 (Bankr. D. Wyo. January 30, 2002); United States v. LaBine, 73 F. Supp. 2d 853, 858 (N.D. Ohio 1999) (transfer to trust is a conveyance); Gilchinksy v. National Westminster Bank, 159 N.J. 463, 478 n.4, 732 A.2d 482, 490 n.4 (1999).

Mr. Sullivan concludes that asset protection planning is permissible so long as it is based on what he calls the "Long Range Solvency Calculation": A calculation of present assets, plus reasonably foreseeable future assets, minus present debts, minus reasonably foreseeable future debts, yielding a net surplus that can be protected against the claims of future creditors.[83]

Finally, Mr. Duncan Osborne, a leading asset protection scholar from San Antonio,[84] argues that Texas law does not protect creditors who could not reasonably have been foreseen by the transferor. He bases his argument on the preamble to Texas Business & Commercial Code § 24.005(a), which limits standing to void transfers made with actual fraudulent intent to creditors who acquire a claim "within a reasonable time before or after the transfer".

D. <u>The Case Against Offshore Asset Protection Trusts</u>.

Mr. Engel, Mr. Sullivan and Mr. Osborne carefully constructed arguments that not all creditors are "future creditors" entitled to the protection of the fraudulent transfer laws. But their arguments simply do not work, because they are aimed at the wrong issue.

The issue is not what creditors are entitled to sue under the fraudulent transfer laws. Outside of Texas, all creditors -- present and future -- are so entitled: The statutes say so simply and clearly. Indeed, the Texas statute compels the conclusion intent to defraud future creditors is fatal to a transfer. Moreover, such authority as this non-Texas has been able to unearth indicates that the Texas limitation is a statute of repose, not a requirement that the claim be reasonably foreseeable.[85]

Mr. Sullivan's argument that plaintiffs with unprecedented, or "bizarre", or "attenuated" claims are not "creditors" protected by the UFTA is based on faulty logic: he relies on cases holding that a person is not a creditor *as of a given date*, but those cases are irrelevant to the question of that person's rights under the UFTA *in the future when the person does have a claim*. The Second, Third and Eleventh Circuits did indeed hold that such plaintiffs do not have claims, and are not creditors, during a bankruptcy case, but when those plaintiffs obtain their claims, and become creditors, the statute will apply and nothing in the holdings suggests otherwise. To use *Piper* as an example: The baby who is born the day after the bankruptcy case is over may not have a claim in the bankruptcy case, but it does have a claim when it dies in an air crash two years later.[86] It will be entitled to the protections of the UFTA. That much is clear from the asbestos cases, where the plaintiffs' claims do not "arise" until their injury is manifest,

83 Sullivan, *supra* n. 75, at 988-990.

84 *See* notes 2 & 16, *supra*, Text at Notes 170-172, *infra*.

85 Dole & Teofan, The Non-Uniform Texas "Uniform" Fraudulent Transfer Act, Sw. L. J. 1029, 1044-45 (1989). If anything, the purpose of the "reasonable time" limitation seems to have been to preclude creditors with ***stale claims*** -- not ***future claims*** -- from voiding fraudulent transfers.

86 *See* Fogel v. Zell, 221 F.3d 955 (7th Cir. 2000) (Where plaintiffs' pipes burst after chapter 11 bar date for filing claims and participating in settlement of fraudulent conveyance claim, plaintiff had a valid claim and its own fraudulent conveyance lawsuit, and was not bound by settlement).

which can be ten or twenty years after the manufacturer has finished using asbestos, and yet such plaintiffs are clearly protected by the UFTA.[87]

In addition, the logical integrity of Mr. Sullivan's argument has been seriously challenged, and his probability-weighted "Long Range Solvency Calculation" invalidated, by United States District Judge Wolin's prominent decision in *Committee of Asbestos Personal Injury Claimants v. Sealed Air Corporation (In re W.R. Grace & Co.)*.[88]

As the case name implies, Grace is one many corporations forced into chapter 11 by the increase in asbestos litigation since 1999. However, in the mid-1990s asbestos lawsuits had been in decline, and Grace looked very solvent. So in 1998, Grace sold a $5 billion division to Sealed Air Corporation; all but about $1.3 billion of the proceeds went to Grace's shareholders. The transfer to Sealed Air was potentially a fraudulent conveyance if Grace was, at the time, insolvent. Grace does not believe it is insolvent today, since Grace believes that the vast majority of asbestos claims against it are meritless,[89] but Grace surely did not believe it was insolvent in 1998.

Judge Wolin, however, held that a reasonable belief in solvency was not relevant to the question of whether Grace was or was not solvent in 1998. Solvency had to be measured not by what was "reasonably anticipated" in 1998, but what is known as of the 2002 lawsuit.

Judge Wolin noted that UFTA § 4(a)(2) voids transfers for inadequate consideration where the assets of the debtor were "***unreasonably*** small" or where the debtor "believed ***or reasonably should have believed***" that it would incur debts beyond its ability to pay. By contrast, UFTA § 5 simply voids transfers for inadequate consideration where the debtor is insolvent without any requirement of reasonableness:

> Section 5 makes no mention of the debtors [*sic*] knowledge or reasonableness of estimation in relation to its own insolvency. As framed by the statute, the only question is whether the debtor was insolvent on the transfer date or became insolvent. To the extent defendants would have the Court read reasonable estimation of liabilities into section 5, such an argument would be contrary to one of the most fundamental and universally accepted notions of statutory construction. Section 4 explicitly invokes reasonableness. Section 5 does not. If one limits one's consideration to the literal terms of the statute, the omission of reasonableness from the solvency prong of section 5. The clear implication of the text of the two sections is that solvency under section 5 is to be based upon the objective reality of whether "the debtor was

87 *See*, *e.g.*, Lippe v. Bairnco Corp., 225 B.R. 846, 855-56 (S.D.N.Y. 1998).

88 281 B.R. 852 (D. Del. 2002).

89 The author represents the Official Committee of Equity Security Holders of W.R. Grace. Like Grace itself, the Equity Committee believes that the vast majority of asbestos claims filed against Grace are completely without merit. The Grace products which allegedly caused the plaintiffs' injuries contain only trace amounts of asbestos, within governmental guidelines, and there appears to be no provable link between the vast majority of the plaintiffs and any Grace product. The overwhelming percentage of the plaintiffs have asserted no injury other than lung scars (a) that are detectable on X-Rays by the plaintiffs' doctors, but not by other doctors, (b) have not caused any medical or health impairment at all, and may never do so.

insolvent at that time" and not be reference to what the debtor may have reasonably estimated its liabilities to be.[90]

Now it is true that Sealed Air had nothing to do with ***intentional*** fraudulent conveyances.[91] However, the principle enunciated in Sealed Air applies with equal force to the debate over whether any future creditor -- even one that was not reasonably foreseeable -- can void a fraudulent transfer. The point is simple. When the legislatures wanted to use the concept of "reasonable foreseeability", they did so -- in UFTA § 4. Just as the legislatures failed to required "reasonable foreseeability" in the determination of solvency, so the legislatures failed to require that future creditors be "reasonably foreseeable."

The question is *intent*: Did the debtor *actually intend to hinder, delay and defraud future creditors?* The *probability* of the creditor's claim is relevant not to establish his standing to be protected by the law, but to determine whether the transferor had the requisite intent.[92]

For almost two hundred years, courts throughout America have held intent to defraud future creditors sufficient to void gratuitous transfers, even when the debtor is solvent.[93] I know of no case asserting, as Mr. Sullivan does, that "solvent people may make fraudulent transfers", and there are cases old[94] and new[95] that hold explicitly to the contrary. Mr. Sullivan

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90 *Id*. at 858. Judge Wolin has cautioned litigants in the Grace chapter 11 not to assume that his decision on when solvency should be measured indicates that he believes that Grace was, in fact, insolvent in 1998 or at any other time. He was preparing to try the issue of solvency in 1998 when the asbestos plaintiffs settled the case for about 25% of what they had asked for.

91 *Id*. at 854.

92 Schell v. Gamble, 153 Cal. 448, 449, 95 P. 870 (1908):

> The record does not show that, at the time of the execution and delivery of the conveyance, there was any probability that any of these parties would ever be a creditor of [the transferor]. It is true that a deed of gift, which we may assume this deed to have been, may be void because made with intent to enable the grantor to defraud future creditors. . . . The question of such fraudulent intent as to such future creditors is one of fact and not of law . . . .

(citations omitted)

93 Sexton v. Wheaton, 21 U.S. 229, 246 (1823) (Marshall, C.J.); United States v. Green, 201 F.3d 251, 256 (3d Cir. 2000) ("The present facts are that the transfer was to a spouse for a wholly inadequate consideration. *No matter how healthy Howard Green's balance sheet might have been, the factual presumption of actual fraud would survive* . . . . On the present facts . . . solvency is an inconsequential factor.") (Emphasis added). *See also* Salmon v. Bennett, 1 Conn. 237, 238-39 (1816); Beasley v. Coggins, 48 Fla. 215, 37 So. 213, 215-16 (1904); Barrows v. Barrows, 108 Ind. 345, 9 N.E. 371, 371-72 (1886); Creed v. Lancaster Bank, 1 Ohio St. 1, 9 (1852).

94 *In re* West, 108 F. 940, 940-41 (2d Cir. 1901) (Creditors who filed a bankruptcy petition alleging a fraudulent transfer were not required to offer any evidence of solvency where they had proved the intent of the bankrupt to defraud creditors).

95 Branch v. FDIC, 825 F.Supp. 384, 399 n.11 (D. Mass. 1993) ("Proof of [insolvency] is not required under sections 548(a)(1) or 544(b) to the extent [Branch's] claims are based on Mass. Gen. L. ch. 109A §7, since

cites no authority for his position beyond a faulty reading of the UFTA.[96] The problem with an offshore asset protection trust -- especially a "sole purpose" trust -- is that its avowed purpose is to put assets beyond the reach of creditors.[97] It will be challenged only when it achieves its purpose -- when it prevents a creditor from being paid. The question thus reduces to the following: *may a future, unknown creditor void a transfer made with explicit and acknowledged intent to hinder, delay and defraud only future unknown creditors?*

With one exception, none of the cases cited by Mr. Engel address that question.

None of the debtors in *First National Bank in Kearney v. Bunn*, *Hemphill Co. v. Davis Knit. Co.* and *Roland v. U.S.* were shown to have explicit intent to hinder, delay and defraud future creditors. These were all cases in which the courts had to decide whether or not to infer intent to hinder, delay or defraud from the circumstances, and they were reluctant to do so where the creditor claiming fraud was nowhere in sight when the transfer was made.[98]

In *Bunn*, the husband transferred his interest in the family home to his wife seven months before borrowing from the plaintiff bank, the bank knew all about the transfer, and the proceeds of the loan were used to pay off pre-existing creditors. The only future creditor, apparently, was the bank -- and the bank knew all about the prior transfer of the house. Nothing in *Bunn* pointed to any intent to hinder, delay or defraud other than the circumstance of the interspousal transfer.[99]

In *Hemphill*, a manufacturer of knitting machines orally agreed to sell the machines to the debtor on credit on or about on or about December 16, 1927. When the debtor could not pay, he executed a "bailment lease" with the manufacturer on or about May 10, 1928. On August 3, 1928 -- approximately four months later -- the debtor requested a line of credit

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this section requires only proof that the transfers were made with actual intent to hinder, delay or defraud. Thus Branch's claims under this later provision are not endangered by the defendants' solvency defense.")

96 Sullivan, *supra*, n. 75, at 1040-41 (1997). The cited pages contain six footnotes (nn. 313-18), but each refers to the statute without case citation. Professor Sullivan enumerates the "badges of fraud" and concludes that if no badge of fraud is shown, then the transfer is not fraudulent. This reading ignores both the actual language and the sense of the statute, which provides that "[I]n determining actual intent under subsection (a)(1), consideration may be given, *among other factors*, to . . ." the badges of fraud. In other words, failure to show any badges of fraud does not protect the transferor if it can be shown that he really did intend to hinder, delay and defraud his creditors. Thus the transferor who writes a letter to his asset protection planner stating, "I intend to hinder, delay and defraud my creditors" is perpetrating a fraudulent conveyance whether or not he is solvent.

97 *See* Cioli v. Kenourgios, *supra* n. 19, 59 Cal. App. at 695-96, 211 P. at 841 (sending money to a foreign jurisdiction is evidence of fraudulent intent).

98 *See*, *e.g.*, Wallace v. Penfield, 106 U.S. 260 (1882) (Harlan, J.) (where husband gave house to wife four years before signing notes to banks, transfer was not fraudulent because all other evidence pointed to husband's solvency and prosperity at time of transfer).

99 *Cf.* Stanko v. Commissioner, 209 F.3d 1082, 1087 (8th Cir. 2000) ("The Commissioner made no attempt to prove that the transfer . . . was made to defraud subsequent contemplated creditors. Therefore, the Commissioner's claim against Jean as successor as transferee is limited to debts in existence at the time of the fraudulent conveyance.")

from its bank, with a financial statement that made no reference to the bailment lease. The debtor defaulted on his loan in May of 1930, the bank seized his assets (including the knitting machines) and the manufacturer sought to replevin the machines based on its bailment lease. It was in this context -- wholly devoid of "actual intent" to defraud of any kind -- that the court required proof that the bailment lease was intended to defraud the particular "future creditor".[100]

The other "Pennsylvania rule" cases all involve gratuitous transfers from husband to wife where no actual intent is shown and the issue is whether a subsequent creditor is entitled to the presumption that such transfers were fraudulent.[101] Where actual intent was shown, the Pennsylvania Supreme Court allowed a future creditor to void a gratuitous husband-to-wife transfer[102] -- even though, in the words of the dissent, it was "pure speculation" as to whether such creditor would exist at all.[103] As noted above, Mr. Engel also cites several cases where a family member sought to recover property which was admittedly given to another family member to keep it out of the hands of creditors.[104] In each case the explicit intent of the transferor to defraud creditors is admitted, in each case no creditor appears to have gone unpaid, and in each case the courts found no fraudulent transfer.

I submit that these cases are not good authority for the proposition in question: whether a future, unanticipated creditor can complain of a transfer intended to put assets beyond the reach of creditors generally. The equities in disputes between transferors and transferees are entirely different than in disputes between unpaid creditors and transferees. The difference is best explained in *White v. White*,[105] where Lola Mae White, 75 and ill, was persuaded by her son to transfer property to him for the explicit purpose of keeping it out of the hands of creditors. Mrs. White, however, had no creditors and did not contract any, and the court refused to find a fraudulent transfer which would bar barring her from recovering her property from her son:

> The rule is recognized that where there is no creditor there is no fraud. The motive with which a conveyance is made and the fears by which it is prompted are of no importance unless there are creditors to be protected.[106]

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100 Today, this case would be decided for the bank as a judgment creditor against the manufacturer as the holder of an unperfected security interest. U.C.C. § 9-317(a)(2).

101 Leopold v. Tuttle, 378 Pa. Super. 466, 549 A.2d 151 (1988); *In re* Chadwick's Estate, 154 Pa. Super. 157, 35 A.2d 582 (1944).

102 County of Butler v. Brocker, 455 Pa. 343, 314 A.2d 265 (1974).

103 *Id.*, 455 Pa. at 349, 314 A.2d at 269 (Manderino, J., dissenting).

104 *See*, *e.g.*, *Klein v. Klein,* 112 N.Y.S.2d 546 (1952); Pagano v. Pagano, 207 Misc. 474, 139 N.Y.S.2d 219 (Sup. Ct. Westchester County 1955), *aff'd*, 2 A.D.2d 756, 153 N.Y.S.2d 722 (2d Dep't 1956); Palumbo v. Palumbo, 55 Misc. 2d 264, 284 N.Y.S. 2d 884 (1967); Wantulok v. Wantulok, 214 P.2d 477 (Wyo. 1950).

105 519 S.W.2d 689 (Tex. Civ. App. 1975).

106 *Id*. at 693.

Finally we come to the one case cited by Mr. Engel where a future creditor complained, and the debtor admitted, that the debtor actually intended to hinder, delay and defraud future creditors generally: *Hurlbert v. Shackleton*.[107]

As previously noted, Dr. Shackleton testified that he transferred assets to his wife in 1983 "[b]ecause I wasn't able to get malpractice insurance, and I wanted to cover all the bases."[108] Dr. Shackleton committed malpractice on the plaintiff on February 20, 1984. The plaintiff -- a prototypical "unknown subsequent creditor" -- sought to void the transfer. The trial court held for Dr. Shackleton. It drew a distinction between "probable" and "possible" future creditors. Classifying the plaintiff only as a "possible" future creditor, the trial court found no cases holding a transfer of assets to be fraudulent as to "possible" future creditors, and dismissed the case. The Court of Appeals reversed:

> Though there is evidence in the record of Dr. Shackleton's intent with regard to the subject transfers, the trial court did not specifically rule on whether he intended to defraud appellant or anyone else in making the transfers. Its focus was instead on the nature of the subsequent creditor, i.e., it focused on whether the subsequent creditor was "possible" or "probable". Appellant's argument is well taken that this is not the relevant inquiry and, as the trial court acknowledged, there is no case law pertaining to such a distinction between creditors.[109]

In short, *Hurlbert* holds directly *against* the basic position of the asset protection bar: There is no difference between "probable" or "possible" creditors. The only question is intent.[110] Indeed, that *Hurlbert* is somehow favorable to its view of fraudulent transfer law is one of the more outrageous positions taken by the asset protection bar.[111]

While no other court has joined *Hurlbert* in specifically rejecting the asset protection bar's distinction between "probable" and "possible" creditors, numerous other cases have voided fraudulent transfers when intent to hinder, delay or defraud was shown by a future creditor, without regard to the "probability" of the creditor.

In *Altman v. Finkel*,[112] Altman was not Finkel's creditor in 1929, the date of the transfer. Altman's transaction with Finkel occurred two years later, in 1931. The trial court dismissed Altman's claim because, at the time of the transfers, Altman was not Finkel's creditor, and there was no proof that any indebtedness to Altman was even contemplated by Finkel. That

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107 560 So.2d 1276 (Fla. Ct. App. 1990).

108 *Id*. at 1277.

109 *Id*. at 1279-80.

110 *Cf.* Hicks v. Sovran Bank, 812 S.W.2d 296 (Tenn. Ct. App. 1991) (even though husband testified that he made gratuitous transfers to wife to protect assets from a downturn in his business, testimony that he had no creditors at the time and therefore did not intend to defraud creditors was sufficient to support jury verdict that husband lacked actual intent to hinder delay and defraud).

111 As noted above, Barry Engel finds the case "compelling" because the appellate court remanded for a finding of actual intent rather than merely entering judgment for the defendant.

112 268 A.D. 666, 52 N.Y.S.2d 634 (1st Dep't), *aff'd*, 295 N.Y. 651, 64 N.E.2d 715 (1945).

dismissal was reversed because Finkel had been found to have had actual intent to conceal his assets from present and future creditors by means of the transfers.[113] In other words, the likelihood or unlikelihood of Altman's claim was irrelevant. What mattered was Finkel's intent.

Likewise, *Hartnett v. Doyle*[114] voided transfers by a partnership to the wives of the two partners by finding that they had entered into a scheme to defraud both present and future creditors, without paying attention to the likelihood or unlikelihood of the creditors that were cheated of payment:

> It is simply unthinkable to any fair and candid mind that these two women on the meager sum of $1500.00 each, in twenty-three years, could accumulate this vast amount of property, while their husbands with a business of approximately $10,000.00 per year at the end of twenty-three years were grossly insolvent and judgment proof.[115]

In the recent case of *Kulp v. Timmons*[116], Timmons, the owner of a boatyard, had transferred assets to a spendthrift trust on January 11, 1985, at a time when he owed one Charles J. Cannon on a judgment. On June 6, 1985, an explosion at the boatyard injured Kulp, who sued, obtained a judgment and then sought to avoid the trust. Kulp was not a creditor at the time the trust was created, and was probably not a reasonably foreseeable creditor -- but his fraudulent conveyance suit succeeded, because the evidence showed "an intent to defraud past ***and future*** creditors".[117] The Delaware Chancery Court held that a transfer to a trust intended to defraud Cannon was a fraudulent transfer voidable by Kulp -- even though Kulp did not have a claim when the transfer was made.

Perhaps the most outrageous case is *Dawson v. Wooten*,[118] which involves a doctor who went a little further than Mr. Klueger's "Doctor Brown."

Dr. Dawson in the late 1970s opened a family practice in Newark. He felt that medical malpractice insurance was too expensive, and that insurance companies settled meritless claims. He felt that as a physician, he was a target for lawsuits. Accordingly, he decided to conceal his assets so they could not be traced to him in the event of a lawsuit. He began transferring assets into various types of trusts.

Dr. Dawson then went further: he appropriated the identity of Everett Wooten, one of his patients, defrauding the Ohio deputy registrar into issuing him an operator's license

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113 *Id*. at 637.

114 16 Tenn. App. 227, 64 S.W.2d 227 (1932).

115 *Id*. at 235.

116 2002 Del. Ch. LEXIS 94 (July 30, 2002).

117 *Id*., Text at Notes 29-30 (emphasis added).

118 82 Ohio App. 3d 548, 612 N.E.2d 800 (1992), *appeal dismissed (without opinion) sua sponte for no substantial constitutional question*, 66 Ohio St. 3d 1455, 610 N.E.2d 420 (1993).

(with his photo) in the name of Wooten.[119] Dawson later bought property in his own name and transferred it into trusts bearing variations on Wooten's name.

When the fraud was uncovered, Wooten sued Dawson for fraud, intentional infliction of emotional distress and invasion of privacy, and sought to void certain property transfers as fraudulent transfers. In addition to awarding Wooten damages, the trial court found (and the court of appeal affirmed) that Dawson had intended to "conceal assets, hinder creditors in determining the extent of his assets, and to defraud potential creditors", and voided all transfers of assets into trusts since 1980.[120]

Perhaps *Dawson v. Wooten* should be discounted because its facts are so egregious, but the holding is directly on point: Dawson's transfers were voided because he planned to defraud creditors in general -- not particular creditors, not likely creditors, but just "potential creditors."

The asset protection bar's position that only "probable" future creditors can complain of intentional fraud is also contradicted by the structure of the fraudulent transfer statutes. They provide that a transaction intended to defraud one creditor may be avoided by all.[121] It seems inconsistent to argue, as the asset protection bar does, that a future and wholly unexpected creditor cannot complain of a transfer intended to put assets beyond the reach of future creditors generally (including herself) if she could complain of a transfer intended to put assets beyond a creditor other than herself.[122]

This principle of fraudulent transfer law -- that a transfer voidable as to one creditor is voidable as to all -- is magnified by American bankruptcy law, which has held since 1931 that the bankruptcy trustee may avoid a fraudulent transfer (no matter how large) in its entirety, for the benefit of all creditors, so long as there is one unsecured creditor (no matter how small her claim) who could void the transfer under non-bankruptcy law.[123]

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119 Dawson had used the library to find the newspaper clip announcing Wooten's birth and the name of Wooten's parents, and used that information to obtain a copy of Wooten's birth certificate, which he used to get the license.

120 *Id*., 82 Ohio App. 3d at 557, 612 N.E.2d at 806.

121 United States v. Fire Masters, Inc., No. 89-86-COL, 1991 U.S. Dist. LEXIS 1670, at *3 (M.D. Ga. Jan. 28, 1991) (a conveyance void as to one creditor is void as to all); *In re* Andersen, 166 B.R. 516, 528 (Bankr. D. Conn. 1994); David v. Zilah, 325 Mass. 252, 256, 90 N.E.2d 343, 345 (1950) (Holder of a 1935 note, who obtained judgment in 1947, could void a 1931 conveyance because it was conceded that such conveyance had been made to defraud creditors at that time); Peerless Mfg. v. Goehring, 131 Conn. 93, 95, 38 A.2d 5, 6 (1944).

122 Severance v. Knight-Counihan Co., 29 Cal.2d 561, 567, 177 P. 2d 4, 8 (1947). "[E]ven if it be assumed that the creditors at the time of the agreement could have been satisfied, the agreement would still have been fraudulent as impairing the rights of future creditors. Future creditors as well as present creditors are protected by the legislation relating to fraudulent conveyances." *Id*.

123 11 U.S.C. § 544(b), codifying Moore v. Bay, 284 U.S. 4 (1931).

Applying the "intentional fraud" provisions to protect only "probable" and not "possible" creditors also makes no sense under the structure of the statutes which have sections proscribing gratuitous transfers when the transferor believes he will (UFCA § 6) or reasonably believes he would (UFTA § 4(a)(2)(ii)) incur debts beyond his ability to pay. The statutes have separate sections proscribing transfers with actual intent to hinder, delay and defraud (UFCA § 7 and UFTA § 4(a)(1)). As the unforeseeability of the creditor is clearly addressed by UFCA § 6 and UFTA § 4(a)(2)(ii), there is no principle of statutory construction compelling its inclusion in UFCA § 7 and UFTA § 4(a)(1). If anything, the opposite is true.

Finally, none of the cases cited by Engel or his fellow asset protection planners is convincing because none of them involves a trust. Each involves a transfer to a human being: a wife, child, relative or friend with an equity of possession the law is not eager to disturb. The law is, and should be, different for a trust set up to shield the transferor's assets while protecting them from his creditors. Such a trust is void under general principles of law prevailing in most American jurisdictions.[124] A trust obtains no equity in the property. There is no reason to read the fraudulent transfer laws as respecting the trust's protection of property from creditors, and the courts have not done so.

In fact, two courts have specifically applied New York law to invalidate offshore asset protection trusts even though the trusts were valid under the law of their own jurisdictions.

In *Duttle v. Bandler & Kass*, District Judge Kimba Wood held that a Liechtenstein trust, established to protect the transferor's assets with a trustee who promised not to appear in any American litigation, was invalid against creditors.[125] Judge Wood found that the trust was established to protect assets from creditors and ignored the Liechtenstein law that would have validated the trust. She brushed aside the beneficiaries' complaint that she lacked jurisdiction over the trustee. The beneficiaries lacked standing to protest lack of jurisdiction over the trustee, and, in any event,

> It would be inequitable to permit a fraudulent settlor of a trust to keep the trustee beyond the equitable reach of a court by selecting a trustee who stated that he would not appear in American court, and refused to submit to deposition on the question of jurisdiction, and then by moving for dismissal of the trustee as a third party.

The transferor established the trust while he was in litigation, so the transfers were voidable under N.Y. Debtor & Creditor Law § 273-a -- a variant of the UFCA voiding, as against plaintiffs, all gratuitous transfers made during their litigation. However, Judge Wood's opinion by its terms looks primarily to whether the purpose of the trust was to defraud creditors, and held it void accordingly. In *Duttle*, Judge Wood had to use the impending litigation to infer intent to defraud creditors to void the trust; with a sole purpose asset protection trust, the proscribed intent would be self-declared.

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124 BOGERT, THE LAW OF TRUSTS & TRUSTEES § 211 at 57-58 (rev. 2d ed. 1992); A. SCOTT & W. FRATCHER, 1A SCOTT ON TRUSTS § 63 at 363 (4th ed. 1987); N.Y. E.P.T.L. § 7-3.1.

125 No. 82 Civ. 5084, 1992 U.S. Dist. LEXIS 8894 (S.D.N.Y. June 23, 1992).

In re Portnoy[126] applied New York law to invalidate a Jersey trust, even though Portnoy filed his bankruptcy *more than six years* after establishing his trust -- i.e., after the statute of limitations on fraudulent transfer actions had run. Portnoy was only a little worse than our fictional Guarantor: He had guaranteed his business' loans from Marine Midland Bank and established an offshore asset protection trust a few months before his loans went into default. His offshore asset protection trust contained many of the features advocated by the asset protection bar: Portnoy was one of a class of beneficiaries of the trust and the trustee retained absolute discretion over which beneficiaries would receive distributions while Portnoy retained the power to fire the trustee. Chief Bankruptcy Judge Tina Brozman found that none of these provisions supported the validity of the trust:

> [The trustee's] fidelity to Portnoy is plainly apparent, for during the course of this very motion, Portnoy successfully directed the trustee to pay from the assets of the trust for a legal analysis of Jersey law for the sole purpose of determining whether Portnoy would be entitled to a bankruptcy discharge under United states law. . . . . If Portnoy is only a mere beneficiary as he so emphatically contends, why are the trust and other beneficiaries blindly footing the costs of issues arising in his personal United States bankruptcy case?[127]

The trust document provided that it was to be governed by Jersey law, but Judge Brozman refused to honor the choice of Jersey law and applied New York to invalidate the trust because the trust offended New York's "deep-rooted policies" against self-settled trusts[128] and because the choice of Jersey law operated "to the detriment of strangers to the agreement, such as creditors or lienholders."[129]

It is worth noting that the recent domestic asset protection trust laws *themselves* imply that transfers defrauding future, unknown, creditors are not protected by the trusts. Take for example, Alaska:

> (b) If a trust contains a transfer restriction allowed under (a) of this section, the transfer restriction prevents a creditor existing when the trust is created, *a person who subsequently becomes a creditor, or another person* from satisfying a claim out of the beneficiary's interest in the trust, unless the . . . transfer was intended in whole or in part to hinder, delay or defraud creditors or other persons under AS § 34.40.010.[130]

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126 201 B.R. 685 (Bankr. S.D.N.Y. 1996).

127 *Id*. at 700-01. *See also* Sattin v. Brooks (*In re* Brooks), 217 B.R. 98 (Bankr. D. Conn. 1998) (disregarding Bermuda and Jersey trusts by holding their provisions offensive to Connecticut public policy; Goldberg v. Lawrence (*In re* Lawrence), 227 B.R. 907 (Bankr. S.D. Fla. 1998). *Cf.* Higashi v. Brown (*In re* Brown), Ch. 11 Case No. 95-3072, Adv. No. A95-00200-DMD, slip op. (Bankr. D. Ak. Mar. 11, 1996), also cited as 4 Ak. B.R. 279 as described in Gingiss, *Putting a Stop to "Asset Protection" Trusts*, 51 BAYLOR L. REV. 987, 1017 & n. 151 (1999) (refusing to uphold Belize trust because established to defraud the settlor's anticipated creditors in violation of Alaskan fraudulent conveyance law).

128 *In re* Portnoy, 201 B.R. at 700-01.

129 *Id*. at 701.

130 AS § 34.40.110(b).

or Delaware or Nevada, each of which provide for attacks by creditors whose claims "arose subsequent to" the establishment of the trust.[131]

It is hard to read these explicit provisions as the asset protection bar wants – to limit fraudulent transfer law as applying only to a limited class of known or knowable creditors. Yet these statutes were promoted by the asset protection bar.[132]

Finally, there is the recent amendment to the Federal Bankruptcy Code, whose history is sufficiently interesting to be told in full.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was the culmination of at least eight years of legislative process. The process started in 1997 with a Bankruptcy Commission appointed by the Clinton Administration, whose report was ignored by the Republican-dominated Congress. Instead, spurred by an ever-increasing wave of consumer bankruptcy filings during some of the most prosperous years in American history (and after heavy lobbying by credit card companies, banks and other consumer lenders), Congress in 2000 passed legislation which, among other things, restricted consumers' access to bankruptcy relief. President Clinton vetoed the bill. After President George W. Bush won the 2000 election, the Republican Congress tried again. The legislation was delayed (and amended) in the wake of public fury over corporate malfeasance in Enron, WorldCom and Adelphia, but failed to pass in 2003 because of an abortion issue. The Senate, evenly split between Republicans and Democrats, passed a bill providing that fines levied against non-violent protestors – such as those who picket abortion clinics in violation of law -- were not dischargeable in bankruptcy. The more-conservative House passed a bill which lacked such a provision, and the two houses couldn't reconcile. When President Bush won re-election in 2004, and control of the Senate passed unequivocally to Republicans, the bill (without the abortion-related provision), after a seven-year lobbying effort reportedly costing over a hundred millions of dollars, headed for enactment, with the Republican leadership refusing to accept any last minute amendments for fear of jeopardizing passage.[133]

However, an amendment relating to asset protection trusts ***did*** pass at the last moment.

This amendment started with a bit of press and political maneuvering by Democrats. On March 2, 2005, Gretchen Morgenson of The New York Times wrote a story

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131 12 Del. Ch. § 3572(b)(2); Nevada Rev. Stat. § 166.170(2).

132 *See* Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*?, 85 CORNELL L. REV. 1035, 1052-53 & n. 88 (2000), citing Douglas J. Blattmachr & Jonathan G.Blattmachr, *A New Direction in Estate Planning: North to Alaska*, TR. & EST. (Sept. 1997). Douglas Blattmachr is a principal in an Alaskan trust company; Jonathan Blattmachr, his brother, is a partner in Milbank Tweed Hadley & McLoy and a leading trusts and estates lawyer.

133 Labaton, *Bankruptcy Bill Set for Passage; Victory for Bush*, THE NEW YORK TIMES March 9, 2005 Section A p.1 Column 1.

contrasting the proposed bankruptcy bill's strict treatment of poor debtors with the same bill's failure to prevent rich debtors from sheltering their assets in state law asset protection trusts.[134]

On March 3, 2005, Senator Charles Schumer – trumpeting The New York Times article – proposed an amendment to Bankruptcy Code § 548 which would have avoided as fraudulent any transfer or transfers to any self-settled trust to the extent all such transfers totaled more than $125,000.[135] Senator Schumer's amendment was voted down, 56 to 39. The New York Times duly reported the defeat with extensive quotes on how the Republican Congress was passing a bill to burden poor people while letting rich people beat the system with asset protection trusts.[136]

However, the Republican Senate did, at the last minute, amend Section 548 by inserting, at the request of Senator Talent of Missouri, a new subsection (e) providing, in part, as follows:

> (e)(1) . . . the trustee may avoid any transfer of an interest of the debtor in property that was made on or with ***10 years*** before the date of the filing of the petition if –
>
> (A) such transfer was made to a self-settled trust or similar device;
>
> (B) such transfer was by the debtor;
>
> (C) the debtor is a beneficiary of such trust or similar devise; and
>
> (D) ***the debtor made such transfer with actual intent to hinder, delay or defaud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted***.

(Emphasis added).[137]

Senator Hatch from Utah – which has adopted asset protection trust legislation – defended the statute the ground that not all self-settled trusts were fraudulent.[138] Senator Talent from Missouri – the first state to enact legislation permitting self-settled trusts – further explained:

> Here is a little background on the problem. Asset protection trusts are trusts that a person forms to shield assets for his or her own benefit.
>
> Although the law has historically allowed property owners to create trusts for others, courts have historically refused to permit someone to tie up his or her own property in such away that he or she can still enjoy it but prevent his or her creditors from ever reaching it.

134 Morgenson, *Proposed Law on Bankruptcy Has Loophole*, THE NEW YORK TIMES, March 2, 2005 Section C (Business/Financial) page 1 Column 5.

135 S. AMDT. 42, Cong. Rec. S 1980-81.(March 3, 2005).

136 Labaton, *Senate Rejects Efforts to Alter Bankruptcy Legislation*, THE NEW YORK TIMES, March 4, 2005 Section C (Business/Financial) Page 4 Column 6.

137 S. AMDT. 121, Cong. Rec. S 2138 (March 7, 2005)

138 Cong Rec. S 2427 (March 10, 2005).

> My amendment states clearly that these trusts cannot be used in bankruptcy to allow a person to shelter their assets to avoid repaying their debts because of a judgment in criminal, civil or bankruptcy court.[139]

Senator Schumer criticized the new statute as ineffectual because, he claimed, intent to hinder, delay or defraud could never be shown. He proposed an amendment to eliminate the requirement of intent to hinder, delay and defraud[140]

Senator Schumer is wrong.

As we have seen and will see, intent is actually ***easy*** to prove in connection with asset protection trusts. The asset protection bar's web sites, brochures, scholarly writings, radio advertisements and correspondence all trumpet the forbidden intent – the intent to hinder or delay future creditors. If the Lawyer markets the asset protection trust as a way to prevent future creditors from getting at the Client's assets, the Client's future creditors will have no problem proving intent.

The new Section 548(e) should end the debate over whether a transfer intended to defraud future creditors is voidable. The statute's 10 year look-back is longer than any state statute of limitations. There is no reason to enact such a long look-back period except to protect future creditors. The statute, as enacted, should make it "game over" for state law asset protection trusts. More than ever, asset protection lawyers will push their clients to go off-shore.

The New York Times, which had twice critized the Republican dominated-Senate for ignoring asset protection trusts, ran no story on Section 548(e) as finally enacted.

E. The Intent of the Clients.

The foregoing sections set forth the asset protection bar's position that only "probable" creditors may complain of an intentional fraudulent transfer, and my own conflicting view that the statute focuses on intent without regard to the probability of the creditor. Does the debate make a difference to the Developer and the Doctor?[141]

The Developer wants to establish an offshore asset protection trust because he is afraid of an event which could trigger substantial tax liability. The IRS is clearly not a creditor

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139 *Id.*, 2427-28.

140 Cong. Rec. S 2138 ("[T]o prove . . . intent, especially when the filer would want to make sure that intent could not be proven and would leave no paper trail, no documents or anything else, would be next to impossible. So in a sense, it would not close the loophole at all."); Cong. Rec. S2427 (March 10, 2005) (criticizing the statute as requiring "a showing of intent to defraud in order not to shield the assets. Well, give me a break. . . Which millionaire is going to hire a lawyer and say, make sure you leave a paper trail so they can prove intent. Of course, one cannot prove intent, particularly if the actual intent is to hide the assets.")

141 The Guarantor is already indebted to the FDIC-insured bank, so foreseeability is not at issue.

at the time of the transfer: income tax liability does not become a "claim", for fraudulent transfer purposes, until the day the tax return is due.[142] Does the IRS qualify as a "probable" future creditor? The limited case law says it does. In *United States v. Chapman*,[143] the taxpayer was a gambler who had previous troubles with the IRS and therefore liked to keep his assets in cash "to avoid the reach of the IRS."[144] In 1968 he made gifts of all his non-cash assets to his minor son. Wagering excise taxes for the years 1971-72 were subsequently assessed against the taxpayer, and the United States moved to avoid the fraudulent transfers. Brushing aside testimony that the gifts were intended to preserve assets from gambling losses, the district court found that the transfers were made with actual intent to hinder, delay and defraud the United States of future wagering excise taxes then due and to become due, and the Fifth Circuit affirmed.[145]

How about the Doctor? He is concerned about future unknown tort claimants. Are those tort claimants not "probable" creditors entitled to complain of fraudulent transfers?

I make no defense of American tort laws, jury trials or contingency fees which have encouraged an explosion in personal injury claims. The Doctor may have an unblemished record with respect to his patients and may be wholly innocent of malpractice. But malpractice suits are statistically likely events. That is why doctors carry insurance. When the Doctor establishes an offshore asset protection trust to shield assets from malpractice claims, his "intent" is directed at precisely those creditors who are most likely to arise in the course of his business. Can it really be said that these creditors are not "probable" creditors within the protection of the fraudulent transfer laws?

F. A Bankruptcy Lawyer's Conclusion on Fraudulent Transfers.

The asset protection bar's view of fraudulent transfers and future creditors is formed in large part by its lack of exposure to fifteen years of giant chapter 11 reorganizations that have routinely dealt with "future creditors".

These cases fall into two types.

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142 Hartmann v. Lauchli, 238 F.2d 881, 887 (8th Cir. 1956); United States v. Brown, 820 F. Supp. 374 (N.D. Ill. 1993).

143 756 F.2d 1237 (5th Cir. 1985).

144 *Id*. at 1241.

145 *Cf. U.S. v. Grant*, 2005 U.S. Dist. LEXIS 22440 text at note, and note, 9 (ordering repatriation of funds transferred to a foreign trust before tax was assessed) (Sept. 2, 2005) (*dicta* in Wagner v. C.I.R., TC Memo 1958-112, 1958 WL 1181 (Tax Ct.), 17 T.C.M. (CCH) ¶ 569, 17 T.C.M. (CCH) ¶ 949, T.C.M. (P-H) 58,112 (Tax Ct. 1958), *aff'd*, 279 F.2d 12 (7th Cir. 1960):

> "[W]e recognize that an intent to hinder, delay or defraud the Government of its taxes on the part of a transferor may be found before a tax liability has accrued . . . "

This opinion runs approximately 160 pages in WestLaw©; the quoted passage occurs in Part III of the opinion at * 153.

First, the mass tort cases -- *UNR Corporation, Johns Manville, A.H. Robins, Eagle Picher, H.K. Porter, National Gypsum, Hillsborough Holdings, Keene Corporation and Dow Corning*. Each was dominated by "future creditors" who would fit the asset protection bar's definition of unforeseen creditors. Fraudulent transfers were not an issue in every case, but wherever they were an issue, the "unforeseen" tort creditors were principal beneficiaries of the fraudulent transfer attack.

Second, the leverage buyout cases: *Revco, Interco, Best Products, Wieboldt, McCall Patterns, Morse Tool, Healthco* and *O'Day*, to name only a few, where fraudulent transfer became an issue. In each case, the debtor's collapse injured trade creditors who became creditors after the leveraged buyout. Other than two criticized decisions in the Ninth Circuit,[146] the courts universally held that it made no difference that such creditors became creditors after the leveraged buyout and that such creditors could not have relied on pre-LBO financial condition of the debtor.[147] Issues of "reliance" and ability to withhold credit were found irrelevant.[148]

These are the cases and the principles which ring loudest in the ears of bankruptcy lawyers and, I predict, bankruptcy judges. They are wholly inconsistent with protestations of the asset protection bar that "[u]nknown future claimants of the [transferor], clearly not having relied on their debtors' previously transferred property, do not have standing as injured parties entitled to void the conveyances previously made by [their] debtors",[149] or that a transferor has no duty to preserve his property for the benefit of future creditors.[150] Neither of these statements are true in the context in which their speakers wish them to be applied. A person cannot transfer all of his assets to a spouse before engaging in business, thereby transferring the risks of the business to his creditors.[151] If the LBO and asbestosis cases show anything, they show that totally unanticipated creditors who have not relied on their debtor's previously transferred property or financial condition have standing to void a transfer. The case that established the voidability of leveraged buyouts -- *In re Gleneagles* -- allowed an involuntary creditor, the United States

146 Kupetz v. Wolf, 845 F.2d 842 (9th Cir. 1988); Credit Managers Ass'n of Southern California v. Federal Co., 629 F.Supp. 175 (C.D. Cal. 1985). For criticism of these decisions *see*, *e.g.*, R. ROSENBERG & L. KING, COLLIER LENDING INSTITUTIONS AND THE BANKRUPTCY CODE ¶ 3.06[3] at 3-74.27 (Matthew Bender 1996) ("*Kupetz* . . . had to ignore the literal language of section 548 of the Bankruptcy Code and the Uniform Fraudulent Conveyance Act").

147 *In re* Integra Realty Resources, 198 B.R. 352, 363 (Bankr. D. Colo. 1996); *In re* Healthco Int'l, 195 B.R. 971, 980 (Bankr. D. Mass. 1996) (Queenan, B.J.); SPC Plastics Corp. v. Griffith *(In re* Structurlite Plastics Corp.), 193 B.R. 451, 458-59 (Bankr. S.D. Ohio 1995) *rev'd in part & remanded on unrelated grounds*, 224 B.R. 27 (6th Cir. BAP 1998); Official Unsecured Creditors Comm. v. Citicorp North America, Inc. *(In re* Aluminum Mills Corp.), 132 B.R. 869 (Bankr. N.D. Ill. 1991); *In re* Morse Tool, Inc., 108 B.R. 389, 390-91 (Bankr. D. Mass. 1989).

148 United States v. Tabor Court Realty *(In re* Gleneagles*)*, 803 F.2d 1288, 1297 n. 42 (3d Cir. 1986).

149 Kruse, *Fraudulent Transfers*, 1 OSBORNE, ASSET PROTECTION, *supra* n. 42, Ch. 2 § 2:26 at 21.

150 Engel, *Sole Purpose Asset Protection Planning, supra* n. 64.

151 UFCA § 5, UFTA § 4(a)(2)(ii); Sexton v. Wheaton, 21 U.S. at 246.

government, to complain of a mortgage granted in fraud of creditors, without any issue of "reliance" or foreseeability.[152]

[152] United States v. Tabor Court Realty *(In re* Gleneagles), 803 F.2d at 1297 n.2.

III. THE RESPONSIBILITY OF THE LAWYER.

Now we come to the heart of the matter: the exposure of the lawyer for the wrong of the client. As a lawyer, he may be exposed to discipline under the rules governing the professional conduct of lawyers in his state. As an individual, he may be exposed to civil or criminal liability under state and federal laws. These exposures may or may not be congruent, as is shown below.

A. Ethical Prohibitions: Canons, Code and Model Rules.

A lawyer practices law under license granted by his state, and each state has adopted rules governing the conduct of the members of its bar. There is an odd parallelism between fraudulent transfer law and rules governing lawyers. Like fraudulent transfer law, the rules governing lawyers have gone through three iterations: the 1908 Canons of Professional Ethics ("Canons"), the 1970 Code of Professional Responsibility ("Code") and the 1983 Model Rules of Professional Conduct ("Model Rules").

Just as UFCA and UFTA were promulgated by a private group (the National Commissioners for Uniform State Laws) for enactment by the states, so the Canons, Code and Model Rules were adopted by a private group (the ABA) for legislative enactment or judicial adopting by the states.

Like the UFTA, the Model Rules have been adopted in about two thirds of the states.[153] Like the UFCA, the Code remains in force in about 10 states, including New York (which has also retained the UFCA).[154]

As in fraudulent transfer law, there are states which have their own unique rules, but here there is difference: while none of the major commercial states have enacted non-uniform fraudulent transfer, California -- with one sixth of all American lawyers -- has adopted its own rules of professional conduct.[155]

The Canons, the Code, the Model Rules and the California Rules are all slightly different in ways that matter to the lawyer whose client wants to shield assets from creditors. We start with the Canons:

Canon 16

> A lawyer should use his best efforts to restrain and to prevent his clients from doing those things which the lawyer himself ought not to do, particularly with reference to their conduct towards Courts, judicial officers, jurors, witnesses and suitors. If a client persists in such wrongdoing the lawyer should terminate their relationship.

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153 Ballsun, *Attorney Liability and Ethics* in 1 J. ASSET PROTECTION, Ch. 4 at § 4.05 6-7.

154 S. Gillers, *Regulation of Lawyers: Problems of Law and Ethics*, 4-5 (1995).

155 *Id*. at 5.

Canon 29

> [The lawyer] should strive at all times to uphold the honor and to maintain the dignity of the profession and to improve not only the law but the administration of justice.

Canon 32

> No client, corporate or individual . . . is entitled to receive nor should any lawyer 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.

The leading case under the Canons is *In re DePamphilis*, where the New Jersey Supreme Court reprimanded lawyers for assisting a client to hinder, delay or defraud creditors and found such conduct sanctionable even though creditors were not actually hurt.[156]

DePamphilis' clients had guaranteed the debts of their deteriorating business, and DePamphilis and his partner Friedman had counseled the clients to transfer their home and other real property to their uncle to keep it away from their creditors. On the advice of their lawyers, the clients and the uncle created a series of bank transactions which made it look like the uncle had loaned the clients money to justify the transfer of the property to the uncle on account of the fictitious loans.

As it happened, the clients managed to sell their business and obtain a release from their creditors. They then fell out with their lawyers over the matter of fees, and their complaint before the New Jersey bar charged the lawyers with unethical conduct. The New Jersey Supreme Court condemned the lawyers' conduct:

> We are fully satisfied that . . . both [lawyers] recommended the transfers and participated in a scheme to defraud creditors. . . . Even if it be considered that the idea of the transfers did not originate with the lawyers . . . they participated in and handled the transaction with actual knowledge of its true character and purpose. . . . Any such conduct is unquestionably unethical and unprofessional despite the fact it may be thought to serve the client and no one may be actually injured. It is dishonorable, enables violation of the law and brings the profession into disrepute. Canon 29 of the Canons of Professional Ethics imposes on all attorneys the obligation to 'strive at all times to uphold the honor and to maintain the dignity of the profession.' 'The 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 15. No lawyer should render any service or advice involving disloyalty to the law whose ministers we are [citing Canon 32][157]

The Court found the lawyers' response -- that they were only executing the wishes of their clients -- to be no excuse,[158] and limited its sanction to a reprimand only because the case was one of first impression.

The Canons were a mixture of exhortation and prescription. The drafters of the Code elected to divide the two, placing exhortation in the Ethical Considerations ("ECs") and

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156 *In re* DePamphilis, 30 N.J. 470, 153 A.2d 680 (1959).

157 *Id*., 30 N.J. at 483-84, 153 A.2d at 687.

158 *Id*., 30 N.J. at 484, 153 A.2d at 687. The Court limited its sanction to a reprimand because the complaint against the lawyers was one of first impression. *Id*.

prescription in the Disciplinary Rules.[159] One EC and several DRs are relevant to the lawyer involved with an intentional fraudulent transfer:

Code DR 1-102(A)(4):

(A) A lawyer shall not:

* * *

(4) Engage in conduct involving dishonesty, fraud, deceit or misrepresentation.

Code DR 4-101(C):

(C) A lawyer may reveal:

* * *

(3) The intention of his client to commit a crime and the information necessary to prevent the crime

Code EC 7-6

> Whether the proposed action of a lawyer is within the bounds of the law may be a perplexing question when his client is contemplating a course of conduct having legal consequences that vary according to the client's intent, motive, or desires at the time of the action. Often a lawyer is asked to assist his client in developing evidence relevant to the state of mind of the client at a particular time. He may properly assist his client in the development and preservation of evidence of existing motive, intent or desire; obviously, he may not do anything furthering the creation or preservation of false evidence. In many cases a lawyer may not be certain as to the state of mind of his client, and in those situations he should resolve reasonable doubts in favor of his client.

Code DR 7-102(A)(7):

(A) In his representation of a client, a lawyer shall not:

(7) assist his client in conduct that the lawyer knows is illegal or fraudulent.

Before analyzing the opinions generated by the Code, it is worth looking carefully at its provisions, and in particular EC 7-6. Throughout this paper I have assumed that the client wants to open an offshore asset protection trust *solely* for the purpose of shielding assets from future creditors, and have argued that such intent makes such trust a fraudulent transfer. In real life, however, a client may have additional reasons for setting up an offshore asset protection trust, some of which are set forth in Section I above. The ability of the lawyer to rely on "reasonable doubts" concerning the client's intent will depend on the circumstances of each client. This issue has troubled tax lawyers for years:

> [EC 7-6] draws a distinction between a client's "existing" state of mind and the "creation" of false evidence. A client's statement that "I am dying and want to reduce my estate by making some gifts" involves little room for "reasonable doubts." A lawyer's assistance in making the gifts and then constructing of a paper record from which to argue with tax officials that the property transferred is not part

[159] ABA Model Code of Professional Responsibility, Preliminary Statement.

> of the client's estate because the gifts were not made in contemplation of death receives no warrant from EC 7-6. To be sure, if the reasons for doubt are grounded in uncertain facts rather than in a desire to reach a strategically advantageous legal position, these can be resolved in favor of the client.[160]

The Code has generated several opinions from the bench and bar condemning lawyer participation in fraudulent transfers. The most detailed exposition of the Code as it applies to fraudulent transfers can be found in the Oregon Supreme Court's decision, *In re Conduct of Hockett*.[161]

Hockett was a lawyer with two clients who were insolvent and being sued by their creditors. He arranged a divorce for the clients (representing both them and their wives) so that Oregon marital property law would transfer the husbands' real property to their wives, out of the reach of creditors. The court concluded that the transfers did not constitute "fraud or deceit" actionable under Oregon law because there was no false representation, and therefore found no "fraud or deceit" under DR 7-102(A)(7).[162]

However, the court held that Hockett had violated DR 7-102(A)(7)'s prohibition against assisting in "conduct the lawyer knows to be illegal":

> It is well settled that some conveyances may not be used to avoid the lawful claims of creditors [citing UFCA] . . . Although this statute is not part of the criminal law, it in effect prohibits specified conduct and provides for a remedy to undo the effect of such conduct. Here, the lawyer assisted the client in what has been determined to be an unlawful conveyance. . . . 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).[163]

However, *Hockett* also acknowledged in a footnote immediately following the above quoted passage that:

> The limits of DR-7-102(A)(7) are anything but clear. SEE C. WOLFRAM, MODERN LEGAL ETHICS 703-04 (1986). . . . "[A] lawyer with a reasonable and good faith basis for concluding that the conduct is legal may so advise a client without risk of incurring a disciplinary sanction for ultimately being proved wrong."

Hockett also held that "assisting clients to cheat creditors is 'dishonesty' under DR 1-102(A)(4)"[164] -- potentially a more important holding, as we shall see.

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160 C. WOLFRAM, MODERN LEGAL ETHICS § 13.3.6 at 700-01 (West 1986).

161 303 Or. 150, 734 P.2d 877 (1987).

162 *Id*., 303 Or. at 157-58, 734 P.2d at 882.

163 *Id*., 303 Or. at 161-62, 734 P.2d at 884.

164 *Id*., 303 Or. at 158-60, 734 P.2d at 882-83. This conclusion, however, is based in part on *Hockett*'s misreading of another case:

> One court has stated that a lawyer's acquiescence in a client's conveyance of property to avoid lawful claims of creditors would be conduct in violation of DR 1-102(A)(4), which "simply stated, requires honesty." *In re* Sedor, 73 Wis. 2d 629, 640, 245 N.W.2d 895 (1976).

The Court suspended Hockett from the practice of law for 63 days.[165]

The New Jersey Supreme Court went further, suspending for six months lawyer Leon Nigohosian for helping transfer and conceal certain real property after his client William Stoecker, a defendant in a civil case, had agreed in open court to settle the case either for $2,500 cash or for a $3,000 mortgage on the property.[166] The following testimony, is particularly apposite to the subject of this paper:

> Q: At the time you formed the corporation for [Stoecker], did he either seek any advice from you or did you give him any advice with regard to disposing of assets or canceling assets so as to defraud any potential creditors?
>
> A: I told Mr. Stoecker I had to be certain in my own mind that there was no chicanery in the matter and there was [sic] sufficient assets to meet the judgment so there was nothing later on. I went into with Mr. Stoecker what the consequences were and I pointed out to Mr. Stoecker the serious consequences of a fraudulent transfer.[167]

The New Jersey Supreme Court found this testimony damning, not exculpatory:

> Under the circumstances the obligation to make disclosure could not be more clear. The failure to fulfill that obligation amounts to a violation of DR 1-102(A)(4), prohibiting conduct involving dishonesty, fraud, deceit or misrepresentation, and DR 1-102(A)(5), dealing with conduct prejudicial to the administration of justice. We continue to honor the premise that "a attorney is under a duty, when the proper administration of justice so requires, to disclose all pertinent and relevant facts to the court so that it may act fairly."[168]

Clearly, the Court was most concerned about the lawyer's misleading the court,[169] but its decision stands for the proposition that a lawyer may not assist a transfer intended to hinder, delay and

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Id., 303 Or. at 159, 734 P.2d at 883. Upon examination, however, *Sedor* turns out to condemn not the lawyer's "acquiescence in a fraudulent conveyance" but the lawyer's preparation of an affidavit falsely alleging a fraudulent conveyance.

165 Where the lawyer not only structures the fraudulent transfer but takes title to the property to shield it from impending claims or liens, the sanctions are much more severe. Florida Bar v. Rood, 622 So.2d 974 (Fla. 1993) (attorney who counseled son to transfer property to him to avoid claims of creditors with pending lawsuit had an additional year's suspension added to year's suspension for other acts); *In re* Yamada, 197 A.D.2d 235, 237-38, 611 N.Y.S.2d 857, 858-59 (1st Dep't 1994) (suspending 69-year old attorney for 3 years for secreting property from IRS tax lien). *See also* South Carolina Ethics Opinion 87-11 (undated), cited in AMERICAN BAR ASSOCIATION, COLLECTED ETHICS OPINIONS 901:7906 (where client is subject to several judgment liens, lawyer cannot conceal proceeds from client's house in lawyer's escrow account until judgment liens expire).

166 *In re* Nigohosian, 88 N.J. 308, 442 A.2d 1007 (1982).

167 *Id*., 88 N.J. at 313, 442 A.2d at 1009-10.

168 *Id*., 88 N.J. at 314, 442 A.2d at 1010.

169 Note that *Nigohosian* had nothing to do with the settlement announced in open court. He was retained after the settlement was announced in order to set it aside, which he moved to do shortly before assisting in the transfer of the property. *Query*: would the New Jersey Supreme Court have been less censorious if Nigohosian had arranged the transfer before appearing in court? If he had never appeared in court?

defraud a creditor *even if the lawyer reasonably believes that the transferor can easily satisfy the creditor's claim*.[170]

Nigohosian dealt with a transfer that was clearly intended to hinder, delay and defraud a known creditor. Research has disclosed no judicial opinion under the Code addressing the ethics of transfers aimed at hindering unknown future creditors. There is, however, one ethics opinion from South Carolina that indicates that aiding such transfers would be ethical. The Opinion so clearly supports the asset protection bar that it is worth quoting at length:

> Summary:
> A lawyer may not transfer a client's property from the client's name to the client's spouse's name in order to avoid the likely possibility that the client's creditors could recover the property if a judgment were rendered against the client.
>
> Question:
> Do the canons prohibit an attorney from transferring a client's property from his name to his spouse's name in anticipation of the possibility of a judgment being placed against the client?
>
> Opinion:
> The sole purpose of the transfer would be to avoid the possibility that a creditor or creditors could recover a deficiency judgment against the property so conveyed.
>
> Such conduct solely for the purpose of an immediate probability of judgment [sic] would be in violation of DR 7-102(A)(7) . . . .
>
> *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 the transfer was solely for the purpose of avoiding creditors, it could not be done by an attorney for a client. If however, there does not exist the immediate reasonably 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).*[171]

If South Carolina's view of lawyer responsibility were correct under the Code, it would be even more correct under the Model Rules, which provide in relevant part as follows:

> Terminology:
>
> [4] "Fraud" or "Fraudulent" denotes conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information.

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170 Given the relatively trivial dollar amounts involved in the litigation and the amount of money Stoecker was clearly spending to win it, it is easy to believe Nigohosian's testimony that Stoecker had more than sufficient assets to satisfy the plaintiff.

171 S.C. Bar Ethics Advisory Opinion 84-2 (undated), summarized in Collected Ethics Opinions, *supra* n. 165, at 1980-85 801:7912. The opinion concludes as follows:

> If the transfer is only for the purpose of avoiding the possibility of a judgment against the client, it would probably be a violation of the canons. However, if its sole purpose it to avoid the likely probability of a judgment, then it could not be done.

The first sentence appears to inadvertently omit the word "not" after the word "probably".

Model Rule 1.2:

*   *   *

(d) 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 of application of the law.

Model Rule 4.4:

In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay *or burden* a third person, or use methods of obtaining evidence that violate the legal rights of such a person.

Model Rule 8.4:

It is professional misconduct for a lawyer to:

*   *   *

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation.

Comment to Model Rule 8.4:

[1] Many kinds of illegal conduct reflect adversely on fitness to practice law, such as offenses involving fraud and the offense of willful failure to file an income tax return. However, some kinds of offense carry no such implication. Traditionally, the distinction was drawn in terms of offenses involving “moral turpitude.” That concept can be construed to include offenses concerning some matters of personal morality, such as adultery and comparable offenses, that have no connection to fitness for the practice of law. Although a lawyer is personally answerable to the entire criminal law, a lawyer should be professionally answerable only for offenses that indicate lack of those characteristics relevant to the law practice. Offenses involving violence, dishonest, or breach of trust, or serious interference with the administration of justice, are in that category. A pattern of repeated offenses, even ones of minor significance when considered separately, can indicate indifference to legal obligation.

These provisions represent a retreat from the Code. Whereas DR 7-102(A)(7) forbade assisting a client in “*illegal*” or “fraudulent” conduct, Model Rule 1.2(d) only forbids assisting “*criminal* or fraudulent” conduct. This difference is not accidental. The commission that drafted the Model Rules originally favored a bar against a lawyer’s assisting a client to conclude an agreement “that the lawyer knows or reasonably should know is illegal, contains legally prohibited terms, would work as a fraud, or would be held to be unconscionable as a matter of law.” The commission subsequently retreated to a recommendation that a lawyer be prohibited from counseling or assisting a client “in the preparation of a written instrument containing terms the lawyer knows are expressly prohibited by law.”[172] As noted, the final Model Rule retreated further, barring only assistance of “criminal” -- not “illegal” -- conduct.

Recall that in *Hockett*, the Oregon Supreme Court held that fraudulent transfers, though not criminal, were “illegal” under DR 7-102(A)(7) and thus warranted sanction. The

172 WOLFRAM, *supra* n. 160, at 705.

fraudulent transfers would presumably escape sanction under Model Rule 1.2(d) because they were not criminal. The definition of "Fraud" or "Fraudulent" in the Model Rules' section on Terminology also confirms the *Hockett* holding that a fraudulent transfer is not a "fraud."

What this means is not entirely clear. Professor Wolfram concluded in 1986 that a lawyer who assists client conduct that "violates the law of torts, contracts, property, or some other noncriminal law that does not deal with fraud . . . definitely commits no professional offense."[173]

As of March 1997, there was no reported decision applying the Model Rules to fraudulent transfers,[174] but there is a detailed ethics opinion: the Connecticut State Bar's 5-page Informal Ethics Opinion 91-22.[175] The Connecticut opinion starts by following Wolfram's analysis:

> [W]hether or not a particular transaction is a fraudulent transfer as a matter of substantive law is not the decisive factor in applying the [Model] Rules. The decisive factors are whether the lawyer knows that the transfer constitutes 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). . . . [The reason is] that 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.[176]

The opinion based its distinction between "illegal" and "criminal" on the "narrowing" of DR 7-102(a)(7) through several drafts to the current Model Rule 1.2(d), as set forth above. The opinion reviews *Hockett* and concludes that although the prohibition against "dishonest" conduct appears no different in Model Rule 8.4(c) from its predecessor DR 1-102(A)(4), the narrowing of Model Rule 1.2(d) suggests that Model Rule 8.4(c) should be read more restrictively and should apply only where each of the following elements is present:

1. the transaction is a fraudulent transfer;
2. the lawyer knows the transaction is a fraudulent transfer;
3. the lawyer knows of a purpose to deceive creditors or that there is no other substantial purpose than to burden or delay creditors; and
4. the lawyer either counsels or assists the client in carrying out the transfer.[177]

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173 WOLFRAM, *supra* n. 160, at 703.

174 Various LEXIS searches have failed to discover any case which measures fraudulent transfers against the Model Rules. The Annotated Model Rules cites one case, People v. Bennett, 843 P.2d 1385 (Colo. 1993), for the proposition that a lawyer's participation in a fraudulent transfer violates Rule 8.4(c), but upon inspection *Bennett* is actually a case under the Code, not the Model Rules, in which the lawyer admitted violating DR 1-102(4).

175 Opinions of the Connecticut State Bar at C-86 (1991).

176 *Id*. at C-87.

177 *Id*. at C-88.

The opinion noted that "fraudulent transfers delay and burden those creditors who would be inclined to try and satisfy their unpaid debts from property of the debtor" and concluded that "[i]f there is no other substantial purpose, Model Rule 4.4 applies."[178]

The request which led to the Connecticut opinion referred to transfers which shielded assets from existing creditors, not future ones, so the opinion does not directly address the central issue of this paper: whether an offshore asset protection trust is unethical when constructed solely to shield assets from future unknown creditors. However, the reference to Model Rule 4.4 is potentially dangerous for the asset protection bar. Model Rule 4.4 precludes a lawyer from assisting an action whose sole purpose is to "burden" third parties. Where the intent to burden third parties is clear -- as it is in a sole purpose offshore asset protection trust -- whether or not such third parties are known or foreseeable does not appear to matter under Rule 4.4.

We turn finally to California, which regulates lawyers both by statute in its Business & Professions Code and by a set of rules adopted by the California Supreme Court in 1992. The following provisions of the statute and rules have been cited by courts in their consideration of the lawyers' responsibility for fraudulent transfers:

Business & Professions Code

§ 6067 Oath

Every person in his admission shall take an oath to support the Constitution of the United States and the Constitution of the State of California, and faithfully to discharge the duties of any attorney at law to the best of his knowledge and ability. A certificate of the oath shall be indorsed upon his license.

§ 6086 Duties of Attorney

It is the duty of an attorney:

(a) To support the constitution and laws of the United States and of this State . . . .

§ 6106. Moral Turpitude, dishonesty or corruption irrespective of criminal conviction

The commission of any act involving moral turpitude, dishonesty or corruption, whether the act is committed in the course of his relations as an attorney or otherwise, and whether the act is a felony or misdemeanor or not, constitutes a cause for disbarment or suspension.

If the act constitutes a felony or misdemeanor, conviction thereof in a criminal proceeding is not a condition precedent to disbarment or suspension from practice therefor.

Rules of Professional Conduct

Rule 3-210 Advising the Violation of Law

> 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. A member may take appropriate steps in good faith to test the validity of any law, rule, or ruling of a tribunal.

On their face, these provisions look little different from the Code or the Model Rules. They have, however, been applied with greater severity against lawyers who assist their

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178 *Id.*

clients in fraudulent transfers, because California has a statute making the participation in a fraudulent transfer a crime:

Penal Code

§ 531 Transfers in Fraud of Creditors

Every person who is a party to any conveyance made to defeat, hinder or delay creditors or others, is guilty of a misdemeanor.

Armed with a civil code governing lawyers and a criminal provision barring fraudulent transfers, California courts have been disciplining lawyers for advising fraudulent transfers since 1948, starting with *Townsend v. State Bar of California*.[179]

Townsend had represented Bernice Von der Senden for years before he defended her in 1942 against a civil lawsuit to repossess an automobile and recover damages from its detention. The case was submitted for decision on March 2, 1942, and two weeks later the court informed plaintiff's counsel that it was about to render decision for plaintiff. Plaintiff's counsel called Townsend:

> 'I stated to him over the telephone . . . that I had a great deal of trouble in trying to get this automobile and personal effects which were subject to a chattel mortgage and that I did not want my client to bear any more expenses in this matter . . . . He [Townsend] told me to give him about a week, and I would hear from him.'[180]

The court entered judgment for plaintiff on March 23, 1942.

It turned out, however, that on February 2, 1942 -- 28 days before the case was submitted to the trial court for decision -- Townsend's client on his advice executed a deed of real property to her mother. The deed was recorded on March 21, 1942, several days after the call from plaintiff's counsel and two days before the entry of judgment for plaintiff.

Townsend placed on the deed instructions to the recorder to send it, when recorded, to "A. Catellanos, attorney". Townsend testified at his disciplinary hearing that Catellanos was a "Mexican attorney" and an "associate, but not a member of the California bar," to whom Townsend directed mail that he did not want sent to him. The Supreme Court found that Townsend:

> advised his client . . . that a deed to the property 'should be delivered to her mother right away on account of the judgment.' The recordation of this deed was accomplished by a method designed to hide Townsend's participation in the transaction and, considering all of the circumstances, the committee was

179 32 Cal. 2d 592, 197 P.2d 326 (1948).

180 *Id*., 32 Cal. 2d at 594, 197 P.2d at 327. The opinion does not disclose how or why the court gave only plaintiff's counsel advance notice of a decision in plaintiff's favor, and expresses no view as to the propriety of such advance notice.

fully justified in its conclusion that Townsend advised a conveyance of property for the purpose of defrauding the creditor of his client.[181]

The court held that Townsend had violated Penal Code § 531, and in view of his prior record (he had already been suspended twice before for advertising and for making false statements under oath) suspended him for three years.[182] The California Supreme Court later dealt two- and five-year suspensions in *Coppock v. State Bar of California*[183] and *Yokozeki v. State Bar of California*[184] to lawyers who had held client property in trust to hide it from creditors. *Coppock* in particular shows why the asset protection bar has reason to be concerned about involvement in fraudulent transfers:

> The panel listed lack of harm to petitioner's clients as a mitigating factor, but as we have noted, an attorney has an ethical responsibility to the public, including his clients' creditors, as well as to his clients. In light of our goals of protecting the public, and promoting the integrity of the profession, we cannot attach great weight to this factor.
>
> Petitioner's "good faith" is asserted as a factor in mitigation, but because he admittedly knew Pollock intended to use the trust account to conceal funds from creditors, and knowingly relinquished total control of the account to Pollock, we find this factor unpersuasive.[185]

In addition to California's harsh [penal!] regulation of lawyers by statute, rule and judicial decision, it also has the only ethics opinion which specifically addresses asset protection planning: Ethics Opinion 1993-1 of the Legal Ethics and Unlawful Practice Committee of the San Diego County Bar Association.[186] This opinion is often cited by the asset protection bar as supporting its position, but it is in fact ambiguous and thus worth setting out in some detail:

> PROPRIETY OF ASSET PROTECTION PLANNING
>
> I.
> QUESTION PRESENTED
>
> To what extent may a member of the State Bar of California advise or assist a Client with respect to an avoidance of *existing and identifiable* creditors' rights and a protection of the Clients' assets.

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181 *Id*., 32 Cal. 2d at 596, 197 P.2d at 329.

182 *Id*., 32 Cal. 2d at 597-98, 197 P.2d at 329.

183 44 Cal. 3d 665, 749 P.2d 1317, 244 Cal. Rptr. 462 (1988).

184 11 Cal. 3d 436, 445 n.4, 521 P.2d 858, 863 n.4. Yokozeki had also misappropriated client funds, left California to practice in Japan and refused to appear for his disciplinary proceedings -- all factors which explain the duration of his suspension.

185 *Coppock*, 44 Cal. 3d at 687, 749 P.2d at 1330.

186 Summarized in ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT, 1001:1801 (American Bar Association and The Bureau of National Affairs, Inc. (1991-1995).

II.
SUMMARY

A member who furnishes advice and institutes asset protection techniques may not do so unless the member complies with Rule 3-210 of the California State Bar Rules of Professional Conduct. The member may not participate in violations of criminal and civil law against fraudulent transfers.

III.
STATEMENT OF FACTS

A potential Client seeks advice to protect personal assets from *existing and identifiable creditors*. The Client expresses an intent to transfer assets out of the creditors' reach. Client requests Attorney to advise, prepare and assist in the implementation of an asset protection plan, which may include certain trust instruments, family limited partnerships, and similar techniques.

* * *

V.
ANALYSIS

Civil Code Section 3439.04(a) [UFTA § 4(a)(1)] sets forth that a transfer made or obligation insured by a debtor is fraudulent as to a creditor, in a civil sense, *whether the creditor's claim arose before or after the transfer was made, or the obligation was incurred*, if the debtor made the transfer of incurred the obligation with the actual intent to hinder, delay, or defraud the creditor.

In the instant hypothetical, the potential Client has stated to the Attorney an intent to defraud *existing and identifiable creditors*. The Committee therefore assumes that this admission constitutes "actual intent to defraud." The Committee likewise assumes, without deciding, that the UFTA applies to the hypothetical transaction and would find any transfer to be fraudulent.

* * *

Given the application of the UFTA, any transfer of assets the Client makes would be a transaction which would be the subject of civil remedies. The Attorney's assistance in such transfer would aid a "fraudulent" act as that adjective is understood within the provisions of the UFTA.

The UFTA does not expressly prohibit engaging in a fraudulent transfer, although it does provide post-transfer remedies. Nonetheless, the Committee views the Attorney's knowing assistance in such transactions as contrary to civil law, which therefore will subject the Attorney to discipline under Rule 3-210. . . .

* * *

The Committee is of the opinion that the subject conduct would result in criminal penalties relative to both the Client and the Attorney.[187]

* * *

The Committee does not wish to impose a duty on the Attorney to the creditors of Client, and this opinion should not be so construed. Nonetheless, an Attorney does maintain a duty to protect the public and to promote respect and confidence in the legal profession. Rule 1-100. A client's creditors are but one class within the public to whom an attorney's ethical responsibilities are owed. [Citing *Coppock*]. *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.*

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187 *Citing* Penal Code §§ 531, *see supra* at pp. 42-43, and Business and Professions Code § 6138.

(Emphasis added).

The asset protection bar cites to the repeated emphasis on "existing and identifiable" creditors as indicating that intentionally shielding assets from future unknown creditors is not a violation of California's rule. This may be an overreading of the opinion. The San Diego Ethics Committee was asked only to opine on a transfer aimed at existing and identifiable creditors. The ethics committee had no need to deal with future creditors. Yet the committee quoted the UFTA's protection of creditors whose claim arose after the transfer, and ended by focusing on the client's intent -- precisely the point made above.

B. It's Ethically Wrong -- Now What?

It is clear from the preceding section that a lawyer cannot assist a client to hinder, delay and defraud his creditors. That means a lawyer cannot assist a client in setting up an offshore asset protection trust if the lawyer determines that the trust constitutes a fraudulent transfer. But how is the lawyer supposed to know that?

This paper has focused on the use of offshore asset protection trusts to hinder, delay or defraud unknown future creditors. Where the creditors are present creditors, or creditors that are in prospect, there is universal agreement that the use of asset protection trusts to hinder such creditors is fraudulent. There is also universal agreement that a lawyer cannot establish a trust for a client if to do so would create a constructively fraudulent transfer -- that is, the transfer to the trust would render the client insolvent, leave the client unable to pay its debts as they mature, or leave the client with unreasonably small capital to carry on his business.

Accordingly, the lawyer must conduct due diligence to determine if he can legitimately assist the client in establishing an offshore asset protection trust. Duncan Osborne recommends:

- "a series of client meetings, which may include the client's other lawyers and his or her accountant or financial advisor;"
- an analysis by the client's other counsel and financial professionals of the client's potential fraudulent transfer exposure, including listing existing or threatened claims, placing value on such claims, and a "full financial analysis" to determine if the client is solvent, which involves valuing assets and excluding assets already exempt from creditors' process.[188]

Osborne also recommends determining the client's motive for establishing an offshore trust.[189] Given that Osborne and others have championed the use of offshore asset protection trusts for the sole purpose of shielding assets from creditors, the motive of the client is unlikely to be either benign or difficult to determine. In most cases, the motive of the client will be provided by the lawyer: The offshore asset protection trust is a product sold by the lawyer to

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188 Osborne, *Implementing an Offshore Trust*, 2 OSBORNE, ASSET PROTECTION *supra* n. 2 Ch. 23 §§ 23:02-04.

189 *Id*., § 23:01 at 1-2.

the client, not an action the client thinks of himself for which he then needs legal assistance. In the rare case of the client who comes to counsel with various different motives for establishing an offshore asset protection trust, the lawyer was entitled under EC 7-6 to give the client the benefit of the doubt. For some reason, the Model Rules contain no equivalent to EC 7-6.[190] The effect of this omission is unclear.

In any event, the lawyer who determines that the client's offshore asset protection trust will effect a fraudulent transfer must decline the engagement, and must terminate it if it has already begun.[191]

What if the lawyer discovers that the client's offshore asset protection trust is being used to hinder, delay or defraud creditors? (This could happen if the lawyer discovers that the client failed to disclose existing creditors to counsel, or it is clear the client expected to incur liability immediately after establishing the offshore asset protection trust.) What should counsel do, other than quit? Not much: the lawyer cannot disclose information that might prevent the fraudulent transfer under the Model Rules[192] or California's Business & Professional Code.[193] Disclosure under the Code may or may not be permitted, depending on where the lawyer practices. Code DR 4-101(B) precludes knowing disclosure of client confidences or secrets except that under DR 4-101(C) the lawyer may reveal the intention of his client to commit a crime and the information necessary to prevent the crime, and DR 7-102(b)(1) requires the lawyer to disclose information to prevent a "fraud" -- "except when the information is protected as a privileged communication." Not all states have incorporated the clause last quoted.

C. Civil Liability.

Many lawyers seem to believe that they can escape liability for assisting clients in damaging third parties, so long as the damage arises from the provision of legal advice. According to Section 57 of the Restatement of the Law Governing Lawyers, that is true in certain limited contexts:

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190 The table correlating Code and Model Rule provisions states that EC 7-6 relates to Model Rules 3.4(a)-(b), which relate only to court-room advocacy and have nothing to do with trusting, or not trusting, your client's intent.

191 Model Rule 1.16(a)(1) (a lawyer shall not represent a client or shall withdraw from representation if it will result in violation of the rules of professional conduct or other law); Code DR 2-110(B) (a lawyer shall withdraw from employment if he knows, or its is obvious, that continuation of such employment will result in violation of a disciplinary rule).

192 Model Rule 1.6(a) prohibits a lawyer from revealing information "relating to representation of a client unless the client consents." The only exceptions, contained in Model Rule 1.6(b), relate to disclosures necessary to prevent the client from committing a criminal act that the lawyer believes is reasonably likely to result in imminent death or substantial bodily harm, or disclosures required in litigation between lawyer and client.

193 CAL. BUS. & PROF. CODE § 6086(e): "It is the duty of an attorney: . . . (e) To maintain inviolate the confidence, and at every peril to himself to preserve the secrets, of his client." Ms. Ballsun has questioned how a lawyer can both retain confidences "at every peril to himself" and comply with legal obligations to disclose (§ 6086(e)). Ballsun, *Attorney Liability and Ethics*, 2 ASSET PROTECTION, *supra* n. 153 § 4:31 at 53.

(3) A lawyer who advises or assists a client to make or break a contract, to enter into or dissolve a legal relationship, or to enter or not a contractual relation, is not liable to a non-client for interference with contract or with prospective contractual relations or with a legal relationship, if the lawyer acts to advance the client's objectives without wrongful means.[194]

None of the cited contexts, however, would appear to apply to the lawyer who assists in a fraudulent conveyance by establishing an offshore asset protection trusts. Thus a lawyer who assists in a fraudulent conveyance is no different from a non-lawyer who does so:

Except as provided in § 57, a lawyer is subject to liability to a . . . non-client when a non-lawyer would be in similar circumstances.[195]

So if there is no special protection for lawyers who assist in fraudulent conveyances, the question remains: Does aiding and abetting, or conspiring in, a fraudulent conveyance subject the abettor or conspirator to liability?

Shielding assets from creditors has always been described as "fraudulent". This may explain why "schemes to fraudulently transfer are schemes to defraud" for purposes of a civil RICO action.[196]

The decision in *Fortney v. Kuipers*[197] should hold special interest for lawyers who establish offshore asset protection trusts.

Fortney lost her leg when she was run over by the Kuipers' truck. She sued. The Kuipers, on advice of their lawyers, liquidated some of their assets, transferred others, and then filed for bankruptcy. Fortney and the bankruptcy trustee brought and adversary proceeding to recover the transferred property as fraudulently transferred. Fortney and the trustee also sued the lawyers and their law partners under RICO. The district court sent the case to trial over the lawyers' objection:

[The lawyers] move for summary judgment on all claims alleged in the complaint; they are not named in the (bankruptcy court's fraudulent conveyance) adversary proceeding. . . . We generally agree with the proposition -- asserted over and over again by the [defendant lawyers] that "simply performing services for an enterprise, even with knowledge of the enterprise's illicit nature, is not enough to subject an individual to RICO liability under § 1962(c)" . . . But according to [the Kuipers'] testimony, the attorneys were doing more than just providing legal services; they were calling the shots and formulating the game plan. That most certainly is enough to subject them to RICO liability. . . . Moreover, if [the individual lawyers] are on the hook, their partners are on the hook as well under the Illinois Uniform Partnership Act.[198]

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194 RESTATEMENT (2D) OF THE LAW GOVERNING LAWYERS § 57(3) (ALI 2000).

195 *Id*., § 56. The other subparts of Section 57 are not relevant to this analysis.

196 Cadle Co. v. Schultz, 779 F. Supp. 392, 399 (N.D. Tex. 1991). See also Fortney v. Kuipers, 2001 U.S. Dist. LEXIS 19806 (Nov. 30, 2001).

197 2001 U.S. Dist. LEXIS 19806 (Nov. 30, 2001),

198 Id., at *8-*10.

Fortney's reference to "providing more than just legal services" should offer scant comfort to the asset protection bar. The defendant attorneys were accused of nothing more than advising the judgment debtors to liquidate certain assets and transfer others, of taking the steps necessary to accomplish the transfers and advising the clients to keep the transfer documentation in a safe place. Their clients testified that they took these actions "only because their attorneys told them to" -- which was enough for the court.

How different were these clients from those who move their assets off shore because their attorneys told them to?

Thus a fraudulent transfer is a "fraud" under RICO. It is also a "fraud" in the context of the attorney-client privilege. Courts have repeatedly held that a fraudulent transfer is a "fraud" within the "crime/fraud" exception to the privilege, and thus legal advice given in connection with a fraudulent transfer is subject to discovery.[199]

The first American opinion to so hold and which all other American decisions cite, *In re Grand Jury Subpoena (Marc Rich & Co. v. United States)*[200], involved a criminal grand jury investigation of perhaps the most notorious American tax evader in recent history.[201] The government sought discovery of Marc Rich's attorney's files on the ground that they related to either obstruction of justice or criminal conspiracy to defraud the United States. The Second Circuit was not happy with either theory: there was not interference with witnesses or judicial officials which is the basis for "obstruction of justice," and there was no misrepresentation which is the basis for fraud. Instead, the Second Circuit held that the transfers appeared to be fraudulent transfers under the New York Debtor & Creditor Law, which justified piercing the attorney-client privilege.[202] *Marc Rich*'s holding was echoed (without citation) in 2002 in a truly surprising venue: the High Court of the Cook Islands, which held that a defendant's creation of

199 *See, e.g.,* United States v. Ballard, 779 F.2d 287, 292-93 (5th Cir. 1986); *In re* Grand Jury Subpoena (Marc Rich & Co. v. United States), 731 F.2d 1032, 1041 (2d Cir. 1984); United States v. Barrier Indus., No. 95 Civ. 9114, 1997 WL 16668 (S.D.N.Y. Jan. 17, 1997); Conagra, Inc. v. Strawn Crossing Grain Co., No. 89-3220, 1994 U.S. Dist. LEXIS 1915 (S.D. Ill. Feb. 3, 1994); FDIC v. Cafritz, No. Civ. 91-883 (CRR), 1991 U.S. Dist. LEXIS 11152 (D.D.C. Aug. 12, 1991); *In re* Andrews, 186 B.R. 219, 222 (Bankr. E.D. Va. 1995); *In re* Warner, 87 B.R. 199 (Bankr. M.D. Fla. 1988); Woodall v. Woodall (Ex Parte McDuffie), 624 So. 2d 1063 (Ala. 1993) (where defendant accused of murder had transferred real property to his attorney one week before trial on civil action, trial judge found that allegations property was fraudulently transferred justified compelling criminal defense attorney to disclose terms of his employment by defendant; Supreme Court refused to vacate order by mandamus).

200 731 F.2d 1032, 1041 (2d Cir. 1984).

201 I wrote the description of Mr. Rich as "the most notorious tax evader in American history" in an earlier version of this paper, prior to Mr. Rich's even more notorious pardon by President William Jefferson Clinton on his last day in office, January 21, 2001. Those readers who are tempted to sympathize with Mr. Rich, of who believe that he deserved his pardon, are urged to review the numerous decisions recounting Mr. Rich's willful flouting of the jurisdiction and authority of American courts.

202 731 F.2d 1038-41.

an asset protection trust on the eve of arbitration was evidence of a "fraudulent purpose" sufficient to strip the attorney-client privilege from documents relating to the trust.[203]

In the context of a criminal investigation, it was easy for *Marc Rich* to find that a fraudulent transfer constituted "fraud", but, as noted above, a "fraudulent transfer" without a misrepresentation does not constitute "fraud" either under the Code (as interpreted by the Supreme Court of Oregon) or the Model Rules.

It is not even clear that a fraudulent transfer is a "tort"[204] -- and if it is not a tort, neither a lawyer nor anyone else can be held liable with the transferor as a "co-tortfeasor", as an aider and abettor or as a conspirator.

Aiding and abetting on the one hand, and civil conspiracy on the other, are closely related offshoots from joint tortfeasor liability.[205]

> As pristine legal concepts, conspiracy and aiding-abetting can be distinguished clearly enough. 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. . . .
>
> Aiding-abetting includes the following elements: (1) the party whom the defendant aids must perform a wrongful act that causes and injury; (2) the defendant must be generally aware of his role as part of an overall illegal or tortious activity at the time that he provides the assistance; (3) the defendant must knowingly and substantially assist the principal violation. . . .[206]
>
> The prime distinction . . . is that a conspiracy involves an agreement to participate in a wrongful activity. 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.[207]

The first problem is that liability for "civil conspiracy" or "aiding and abetting" a tortious act is not fully accepted. As recently as 1982, Judge Posner could say:

> 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

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203 A v E and B, Plaint No. 17/2001 (October 10, 2002) at 27-28. The decision is astonishing because under Cook Island law, the establishment of a trust is ***deemed*** not to constitute evidence of an intent to hinder, delay or defraud creditors.

204 Several cases have explicitly held that a fraudulent conveyance is not a tort, *see*, *e.g.*, Wortley v. Camplin, 2001 U.S. Dist LEXIS 20441 at *51 (D. Me. Dec. 10, 2001); FDIC v. S. Prawer & Co., 829 F. Supp. 453, 455 (D. Me. 1993); United States v. Franklin Nat'l Bank, 376 F. Supp. 378, 382 (E.D.N.Y. 1973); Bartol v. Bennett, 56 N.Y.S.2d 314 (Sup. Ct. 1945), in part because of the desire to exploit longer statutes of limitation.

205 American Law Institute, Restatement of Torts (Second) § 876(b).

206 Halberstam v. Welch, 705 F.2d 472, 477 (D.C. Cir. 1983).

207 *Id*. at 478.

> 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.[208]

When the Supreme Court ruled against aiding-abetting liability under Rule 10b-5 in 1994, it noted that "The doctrine [of civil liability for aiding and abetting a tort] has been at best uncertain in application. . . . [T]he common law precedents are 'largely confined to isolated acts of adolescents in rural society.'"[209]

In the particular case of fraudulent transfers, a plurality of states[210] have adopted a rule that one cannot be liable to an unsecured creditor for assisting a fraudulent transfer, either as an "aider or abettor" or as a "conspirator." This is odd when one considers that the first fraudulent transfer case in legal history -- *Twyne's Case* -- held multiple parties liable for a conspiracy to defraud a creditor.

One needs to trace the development of the rule over the last 140 years to understand how the law took such an odd turn.

In 1860, the Supreme Court of the United States held that an unsecured creditor could not hold liable in conspiracy those who assisted the debtor in fraudulently transferring property away from such creditor because the damages suffered by such creditor were too speculative:

> 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 debtor, 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.[211]

The Supreme Court's holding was endorsed 15 years later by the then leading treatise: "If a fraudulent disposition has actually been made by the debtor of his property, a creditor can not, in the absence of special legislation, bring an action in assumpsit, or on the case, against those who combined and colluded with him."[212]

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208 Cenco Inc. v. Seidman & Seidman, 686 F.2d 449 (7th Cir. 1982).

209 Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 181 (1994), *quoting* Halberstam v. Welch, 705 F.2d 472, 489 (D.C. Cir. 1983).

210 Roberts, *Right of Creditor to Recover Damages for Conspiracy to Defraud him of Claim*, 11 ALR 4th 345 (1976); Heroy & Carter, *Alternative Liability Theories for Fraudulent Conveyances: Breach of Fiduciary Duty, Conspiracy, Aiding and Abetting, Negligence and Contribution Rights*, 275, 302 FRAUDULENT CONVEYANCES, PREFERENCES AND VALUATION (S. Mayerson, ed. PLI 1994).

211 Adler v. Fenton, 65 U.S. 407, 412-13 (1860).

212 BUMP, *supra* n. 53, at 505-06.

However, the reason for the rule is that a general creditor could not attack the transfer itself unless she had a lien.[213] An action to recover a fraudulent transfer *was not a tort* -- it was an action to recover property in which the creditor had an interest, and, absent a lien, the creditor had no interest.[214] Note how odd these interpretations were, given the antecedents of fraudulent transfer law. It bears repeating: The common law of fraudulent transfer, which was all the courts had, was a private right of action growing out of a criminal statute.

The Uniform Fraudulent Conveyance Law changed the law: It plainly stated that neither a judgment nor a lien was needed to attack a fraudulent transfer.[215] In effect, the UFCA by legislative enactment found that previous judicial decisions were wrong: The general unsecured creditor's damages from fraudulent transfer could be proved. The damages were the value of the property transferred.[216] Thus there was no need for the general creditor to hold a lien to have an action against the transferee for damages.

Given that the amount of damages was sufficiently fixed to give the general creditor a claim against the transferee, it should have been sufficiently fixed to give a claim against those who aided and abetted the transferee, but the courts held otherwise -- not because they thought about the problem, but because they applied pre-UFCA decisions denying aider and abettor liability without realizing that the law had changed.

Learned Hand was part of the problem. In considering whether a person could be held liable for aiding and abetting a preference under the Bankruptcy Act of 1898, he noted that:

> [C]ourts have generally held as to fraudulent conveyances that a person who assists another to procure one, is not liable in tort to the insolvent's creditors. [Citing *Adler v. Fenton* and other pre-UFCA cases]. In Pennsylvania the rule is otherwise. . . . The reasons ordinarily given are the impossibility of proving any damages, which scarcely seems sufficient; but the result is settled, at least for us.[217]

Hand's opinion was picked up by the United States Court of Appeals for the Ninth Circuit in *Elliott v. Glushon*[218] and given a rationale to preserve the rule against aiding and abetting liability even in the face of egregious facts. Defendant Glushon had responded to accusations that he had aided and abetted a fraudulent transfer by stating: "You know we did it, and we know we did it, but just try and prove it." The Ninth Circuit was "tempted to look to the joint and several liability of joint tortfeasors and to hold that principle applicable to persons who

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213 *Id*. at 511-12.

214 GLENN, *supra* n. 43, § 74 at 122-23.

215 GLENN, *supra* n. 43, § 76 at 129.

216 United Shoe Mach. Corp. v. Becker, 51 F. Supp. 802 (E.D.N.Y. 1943); Damazo v. Wahby, 269 Md. 252, 305 A.2d 138 (1973); Cahill-Mooney Constr. Co. v. Ayres, 140 Mont. 464, 373 P.2d 703 (1962).

217 Duell v. Brewer, 92 F.2d 59, 61 (2d Cir. 1937). Hadden v. United States, 130 F. Supp. 610 (Ct. Cl. 1955) cited both Adler v. Fenton, *supra*, and Hand's opinion for the proposition that under "federal common law" those aiding and abetting a fraudulent conveyance were not liable in tort -- ignoring the fact that there is no federal common law of fraudulent conveyance.

218 390 F.2d 514 (9th Cir. 1967).

plan and carry out a transfer that is fraudulent under the Bankruptcy Act."[219] However, the court found that the statute made transfers voidable, rather than transferees liable, and concluded that "the legislative theory is cancellation, not the creation of liability for the consequences of a wrongful act."[220] In the same vein, the court in *In re Wieboldt Industries, Inc.*[221], refused to allow a claim for indemnity or contribution by fraudulent transfer defendants on the ground that fraudulent transfers are not torts.

Other jurisdictions picked up the pre-UFCA cases to hold that a creditor without a lien could not sue aiders and abetters without noticing that the UFCA had repealed the "gotta have a lien" theory of fraudulent transfer.[222] New York was foremost among them. Almost 30 years before the UFCA was adopted, the New York Court of Appeals[223] held in *Braem v. Merchants' Nat'l Bank*[224] that a creditor must have a lien in order to maintain an action for conspiracy to hinder, delay or defraud. New York courts continued to follow *Braem* even after the UFCA was adopted in a string of cases[225] culminating in the Court of Appeals' 1990 reiteration of the rule in *FDIC v. Porco*.[226]

Porco actually involved a fraudulent transfer of assets offshore: The FDIC sued two bank officers who had allegedly helped a bank director move money to Switzerland. The FDIC argued that the UFCA had overturned the traditional New York rule that required a lien before suit could be brought, but the Court of Appeals disagreed, pointing the long line of post-UFCA decisions that had rejected causes of action for aiding and abetting fraudulent transfers: "It is not for us to write such a remedy into the statute by judicial construction."[227]

After *Porco*, case after case in New York has followed the rule against liability for either conspiracy or for aiding and abetting in connection with a fraudulent transfer.[228] Maine

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219 *Id.*, 390 F.2d at 516.

220 *Id*. *See also* Mack v. Newton, 737 F.2d 1343, 1357-58, (5th Cir. 1984).

221 111 B.R. 169 (N.D. Ill. 1990).

222 Brunvold v. Victor Johnson & Co., 59 Cal. App. 2d 75, 82-83, 138 P.2d 32, 36 (1943).

223 The highest court in New York State.

224 127 N.Y. 508, 28 N.E. 597 (1891).

225 Bartol v. Bennett, 56 N.Y.S.2d 314 (Sup. Ct. 1945), Bradford v. Sonet, 64 N.Y.S.2d 876 (Sup. Ct. 1946), Sussman v. Sussman, 115 N.Y.S.2d 252 (Sup. Ct. 1952).

226 75 N.Y.2d 840, 552 N.Y.S.2d 910, 552 N.E.2d 158 (1990).

227 75 N.Y.2d at 841, 552 N.E.2d at 160, 552 N.Y.S.2d at 912.

228 Gallant v. Kanterman, 198 A.D.2d 76, 80, 603 N.Y.S.2d 315, 318 (1st Dep't 1993), Committee of Unsecured Creditors of Interstate Cigar Co. v. Interstate Distribution, Inc., 210 A.D.2d 283, 285, 620 N.Y.S.2d 78, 80 (2d Dep't 1994); Foufas v. Leventhal, 1995 U.S. Dist. LEXIS 7641 (S.D.N.Y. May 31, 1995); Lippe v. Bairnco Corp., 218 B.R. 294, 303 (S.D.N.Y. 1998).

has followed New York.[229] Alabama,[230] Colorado, California, Connecticut,[231] Indiana, Maryland, Massachusetts, Missouri, Montana, Oklahoma, Rhode Island, Texas[232], and Vermont have dutifully continued to follow nineteenth century "no lien, no action" decisions without considering whether the UFCA required a reexamination of those cases.[233]

A few jurisdictions broke off from the pack and found liability for conspiracy or aiding and abetting fraudulent transfers. Pennsylvania was the first, holding in 1837 that those who assisted a fraudulent transferor in violating the Statute of Elizabeth were liable for conspiracy[234] (a ruling refreshed in a recent decision.[235]) Arkansas followed in 1883,[236] Ohio in 1913[237] and Idaho in 1941.[238] In 1964, Illinois produced the first decision, *Celano v. Frederick*,[239] to hold attorneys liable for assisting in a fraudulent transfer. Celano had obtained a judgment against Frederick and a post-judgment order directing Frederick to turn over all payments on a lawsuit Frederick had instituted against a third party referred to as the Geocaris group. A fluke in the Illinois rules of procedure put the order in question and Frederick and his attorneys arranged to settle the Geocaris lawsuit and to hide the funds from Celano. Celano sued Frederick's attorneys, and the appellate court ruled that "One may not use his license to practice

229 FDIC v. S. Prawer & Co., 829 F. Supp. 453, 455-56 (D.Me. 1993); Wortley v. Camplin, 2001 U.S. Dist. LEXIS 20441 at *51 (D.Me. Dec. 10, 2001).

230 Woodard v. Funderburk, 2002 Ala Civ. App. LEXIS 737 (Sept. 27, 2002).

231 Litchfield Asset Management Corp. v. Howellet, 70 Conn. App. 133, 143-47, 799 A.2d 298, 307-310 (App. 2001).

232 *See*, *e.g.*, FDIC v. White, 1988 U.S. Dist. LEXIS 3020 (March 5-6, 1998).

233 Roberts, *supra* n. 210, 11 A.L.R. 4th at 360-61. *See also* Elliott v. Glushon, 390 F.2d 514 (9th Cir. 1967), where the court limited a bankruptcy trustee's recovery to property received via fraudulent conveyance, reasoning that the anti-fraudulent conveyance provisions of the federal bankruptcy act "were not intended to render civilly liable all persons who may have contributed in some way to the dissipation of those assets. . . . The legislative theory is cancellation, not the creation of liability for the consequences of a wrongful act.").

234 Mott v. Danforth, 6 Sunbury 304 (1937).

235 Marshall v. Fenstermacher, 2005 U.S. Dist. LEXIS 18408 (August 23, 2005) at *30.

236 Daniel v. Vaccaro, 41 Ark. 316 (1883).

237 The Ohio decisions actually appear to be in conflict. Friedman v. Myers, 30 Ohio C.C. 303 (1907), appears to require a lien before an action against aiders and abettors can be brought, but Iddings v. Whitacre, 1 Ohio App. 223, 229 (1913), does not. A recent bankruptcy court decision, *In re Youngstown Osteopathic Hospital Ass'n*, 280 B.R. 400 (Bankr. N.D. Ohio 2002) noted that Ohio law imposed civil conspiracy liability where there is "a malicious combination of two or more persons to injury another in person or property ", and found that intentionally fraudulent transfers constituted the necessary malice. *Id*. at 414.

238 Aker v. Sears, Roebuck & Co., 38 F. Supp. 741 (D. Idaho 1941).

239 54 Ill. App. 2d 393, 203 N.E.2d 774 (1964).

law as a shield to protect himself from the consequences of his participation in an unlawful or illegal conspiracy."[240]

The modern era of aider and abettor/conspiracy liability for assisting a fraudulent transfer began in 1976 with the Wisconsin Supreme Court's decision in *Dalton v. Meister*.[241] Dalton, a creditor of Meister, alleged that Meister had conspired with two banks to hide assets from him. The banks demurred on the ground that Dalton had suffered no legal wrong, citing old "no lien, no action" cases. The Wisconsin Supreme Court brushed aside the old law:

> To the extent that these cases may hold that no actionable conspiracy exists as a result of conveyances of a debtor's property because creditors have suffered no legal wrong, their reasoning was demolished by the subsequent passage of the Uniform Fraudulent Conveyance Act, which makes conveyances of a debtor's property under conditions such as those alleged in the complaint a definite legal wrong. Such tortious conveyances may properly be the subject of a civil conspiracy.[242]

Arizona followed suit in the 1980s in *McElhanon v. Hing,*[243] a case involving an inter-shareholder suit punctuated by the defendant's transfer of his stock to keep it from the plaintiff. Defendant was assisted by Hing, his attorney. The Court of Appeal held that a fraudulent transfer is a legal wrong which may be the subject of a complaint for damages arising out of a conspiracy to commit a fraudulent transfer:[244] "We are not relying on the UFCA per se but on the public policy thereby adopted."[245] However, the court further held that "the action for damages arising from conspiracy to commit a fraudulent conveyance is a remedy that should be used only where the remedies under the UFCA are inadequate."[246] The fact that Hing acted as an attorney in papering the transfer of the stock provided no privilege or shield: He was just as liable as the other parties.[247]

The Arizona Court of Appeals reiterated *Hing* and held another attorney liable for conspiracy in *Pearce v. Stone*[248], this time for setting up a spendthrift trust to receive a fraudulent transfer of real property from the client. Pearce further held that the fraudulent transfer was

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240 *Id*., 54 Ill.App.2d at 400, 203 N.E.2d at 778 *quoting* Wahlgren v. Bausch & Lomb Optical Co., 68 F.2d 660, 664 (7th Cir. 1934), *cert. denied & reh'g denied*, 292 U.S. 615 (1934).

241 71 Wis. 2d 504, 239 N.W.2d 9 (1976).

242 *Id*., 71 Wis. 2d at 521-22, 239 N.W.2d at 18.

243 151 Ariz. 386, 728 P.2d 256 (Ariz. Ct. App. 1 1985), *aff'd in part, vac. in part on other grounds*, 151 Ariz. 403, 728 P.2d 273 (1986), *cert. denied*, 481 U.S. 1030 (1987).

244 *Id*., 151 Ariz. at 393, 768 P.2d at 256. The court in this passage refers to a legal wrong "against a *judgment* creditor", but stated previously on the same page that "a lien is not necessary before there is an actionable wrong."

245 *Id.*

246 *Id.*

247 *Id*., 151 Ariz. at 394, 728 P.2d at 264.

248 149 Ariz. 567, 720 P.2d 542 (Ariz. Ct. App. 1986).

"fraud" which justified stripping the attorney-client privilege.[249] *Hing* and *Pearce* in turn led to the imposition of aiding and abetting liability in *Durant Software v. Herman*.[250] *Durant* held that a law firm associate could be personally liable to his client's creditor for using his law firm to hide client assets in the face of a pending lawsuit:

> An attorney who fraudulently injures a third party is not relieved from liability merely because he acted in the capacity of an attorney. . . . When the attorney goes beyond his role as an advisor, and acts in a maliciously fraudulent way knowingly treading on the legal rights of others, he is not shielded from liability.[251]

Alaska followed *Hing* in 1993,[252] holding that proving liability for participation in a fraudulent transfer scheme required proof of:

- an unlawful agreement
- the specific intent of each participant to hinder, delay and defraud a creditor;
- acts committed pursuant to the unlawful agreement; and
- damages.

In addition, the party against whom damages are claimed must be guilty of actual fraud, that is, the party must know that the transfer will leave the debtor insolvent, that the transfer is for less than fair value, and that the purpose of the transfer is to hinder, delay and defraud the creditor-plaintiff.[253]

In 1998 a California district court upheld a complaint alleging -- against, among others, attorneys -- " a civil conspiracy to violate RICO and the California Fraudulent Transfer Act."[254] In a subsequent decision, dealing with those counts of a complaint against bank which had been a conduit for the fraudulent transfer, the same court again found that civil conspiracy would lie based on the language of UFTA § 7(a)(3)(iii), which provides that a creditor may obtain "any other relief the circumstances may require."[255] This resort to the specific language of the UFTA may give future courts the power -- the courage -- to find in the statute what was there

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249 *Id*., 149 Ariz. at 573, 720 P.2d at 548.

250 220 Cal. App. 3d 460, 257 Cal. Rptr. 200 (Ct. App. 2d Dist. 1989), *dism'd by stipulation as moot*, 795 P.2d 782 (Cal. 1990).

251 *Id*., 257 Cal. Rptr. at 208.

252 Summers v. Hagen, 852 P.2d 1165, 1169-70 (Alaska 1993).

253 *Id*., 852 P.2d at 1169-70.

254 Gutierrez v. Givens, 989 F.Supp. 1033, 1044 (S.D. Cal. 1997).

255 Gutierrez v. Givens, 1 F. Supp. 2d 1077, 1087 (S.D. Cal. 1998). *But see* First Capital Asset Management, Inc. v. Brickellbush, Inc., 219 F. Supp.2d 576 (S.D.N.Y. 2002) (dismissing civil RICO complaint on the ground that nine acts of fraudulent conveyances and concealment of assets through filing false schedules did not "constitute the sort of 'long-term criminal conduct' that Congress sought to target in RICO.") (!?)

from the its beginnings in the sixteenth century: liability for third parties who aid and abet a fraudulent transfer. It also may move California from the majority to the minority camp.[256]

Most recently, in 2005 the Supreme Court of New Jersey held that a lawyer who counseled his client, an Arby's franchisee, to transfer assets out of the reach of Arby's could be held liable by the client's bank for conspiracy to commit a fraudulent transfer.[257]

> The Bank may bring this action even though Arby's was the intended defrauded party. The UFTA contemplates an action by a creditor when a debtor transfers assets with intent to "defraud ***any*** creditor of the debtor".[258]

By my count, that makes fifteen states against aiding and abetting liability and nine states in favor. The plurality rule is under siege. I predict the rule against aiding and abetting liability will eventually fall, either by frontal assault or by flank attack: calling such liability by another name. Thus in New York, the citadel of the plurality rule, one can sue counsel who assisted a corporate debtor in a fraudulent transfer on the ground that the directors of the debtor breached their fiduciary duty to creditors and that counsel aided and abetted such breach.[259] Where the lawyer is a "beneficiary" of the transfer (by taking his legal fees out of the money transferred), he may be liable as an aider and abetter.[260] If an action can be recast not as "fraudulent transfer" but "wrongful diversion of funds",[261] an action for aiding and abetting will lie against the lawyers:[262]

> [Mr. Joel[263] and other] plaintiffs . . . have sufficiently pleaded their causes of action for aiding and abetting liability under the Debtor and Creditor law as against MYB [Maloney, Yeatts & Barr, P.C.]. Plaintiffs have set forth . . . factual allegations . . . indicating that MYB knowingly and recklessly encouraged, induced and assisted Weber and Frank Management, Inc. ("FMI") in diverting Mr. Joel's partnership distributions and concealing that conversion from Mr. Joel, in breach of their fiduciary obligations to Mr. Joel and that a $75,000 payment made to Weber and FMI to MYB, made at a time FMI was insolvent within the meaning

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256 Or maybe not. In 2001, a federal court in the Central District of California hewed to the traditional rule, without so much as mentioning *Guitierrez*. Forum Insur. Co. v. Devere Ltd., 151 F. Supp. 2d 1145 (C.D. Cal. 2001).

257 Banco Popular North America v. Gandi, 184 N.J. 161, 876 A.2d 253 (2005). *See also In re* B.S. Livingston & Co., 186 B.R. 841, 868 (D.N.J. 1995).

258 Id., 178 at n.6, citing N.J.S.A. 25:2-25 (emphasis added by the Court).

259 Crowthers McCall Pattern, Inc. v. Laoir (*In re* Crowthers McCall Pattern, Inc.), 129 B.R. 992, 999 (S.D.N.Y. 1991). Directors have fiduciary duties to creditors once the corporation is in the vicinity of insolvency. *See* Credit Lyonnaise Bank Netherland v. Pathe Communications, No. Civ. A. 12150, 1991 WL 277613, at *34, (Del. Ch. 1991); Clarkson Co. v. Shaheen, 660 F.2d 506, 512 (2d Cir. 1981) (Lumbard, J.).

260 Stochastic Decisions, Inc. v. DiDomenico, 995 F.2d 1158, 1172 (2d Cir. 1993).

261 Atlanta Shipping Corp. v. Chemical Bank, 818 F.2d 240, 250-51 (2d Cir. 1987) (Newman, J.); Joel v. Weber, 197 A.D.2d 396, 602 N.Y.S.2d 383 (1st Dep't 1993).

262 Joel v. Weber, 197 A.D.2d 396, 602 N.Y.S.2d 383 (1st Dep't 1993).

263 The lead plaintiff was "William Martin Joel", described in the headnote to the case (though not the text) as an "entertainer."

> of section 271 of the Debtor and Creditor Law, was a fraudulent conveyance of Mr. Joel's funds . . . . Lacking merit is MYB'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, FMI, which resulted in the alleged conversion of Mr. Joel's partnership distributions. 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 "fraud, collusion, malice or bad faith."[264]

In Texas, as noted above, there is no cause of action for aiding and abetting, or conspiring to commit, a fraudulent conveyance -- but a lawyer may be held liable:

- in civil conspiracy under Texas law to commit economic duress if he advises clients to withhold assets to which they have no colorable right;[265]
- in civil conspiracy under RICO for assisting a violation of the Texas UFTA;[266]
- for aiding and abetting an interference, or conspiring to interfere with, contractual and business relationships, including the right to execute on a judgment debtor's assets.[267]

Finally, a lawyer who receives legal fees for planning a fraudulent transfer may have received a "benefit" from the transfer rendering him liable therefor under the UFTA[268] and Bankruptcy Code § 550(a)(1),[269] which provide:

> (a) . . . to the extent that a transfer is avoided under section 544 [incorporating state fraudulent conveyance law] . . .[or]. . . 548 [the Bankruptcy Code's fraudulent conveyance statute], the trustee may recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property from --
>
> (1) the initial transferee of such transfer ***or the entity for whose benefit such transfer was made***;

(Emphasis added.)

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264 *Id*., 197 A.D.2d at 396-97, 602 N.Y.S.2d at 383-84.

265 Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468 (Tex. Ct. App. 1985).

266 Cadle Co. v. Schultz, 779 F. Supp. 392, 399 (N.D. Tex. 1991).

267 *Id*. at 401.

268 *In re* LaJet, Inc., 1994 U.S.Dist. LEXIS 8967 (August 4, 1994), *reversing* Pender v. Texas NAPCO, Inc., 150 B.R. 648, 653-54 (Bankr. E.D. La. 1993).

269 *In re* Halpert & Company, Inc., 254 B.R. 104 (Bankr. D. N.J. 1999) (New Jersey UFTA). *See also dicta in* Haley v. Sorani, 118 B.R. 753 (Bankr. N.D. Cal. 1990) (under some circumstances, courts would allow the trustee to recover from a third party where the third party conspired with the debtor in making the avoidable transfer, "even if the trustee could not prove that the third party had actually received the property transferred or its proceeds").

It is impossible to sum up the foregoing analyses and apply them to the hypothetical clients. Whether a lawyer can represent any of the hypothetical clients ethically, and without incurring civil liability, turns out to depend on where the hypothetical client lives.[270] It is ironic that so many states have decided that there is no aiding and abetting or conspiracy liability associated with fraudulent transfers, given that the first statute on fraudulent transfers -- the Statute of Elizabeth -- specifically made liable "*all and every the parties to such feigned, covinous, or fraudulent feoffment, gift, grant,* [etc., . .] *before expressed, and being privy and knowing of the same* . . . ." It is even more ironic that New York, the state which most firmly denies that fraudulent transfer is a tort, is also one of the few states where fraudulent transfer is a crime.

D. Offshore Trusts and the Criminal Law.

Let's go back to the Clients: suppose the Guarantor, the Developer or the Doctor decides to put all of his offshore assets in an offshore asset protection trust. The worst that can happen is that the creditors sue the client and the lawyer, right?

Wrong. The worst that can happen is that the client goes to jail.

There is one remedy remaining to the defrauded creditor whose debtor has transferred his assets abroad. The creditor may obtain an order directing him to repatriate assets from the trust, and clap him in jail for contempt when the order is disobeyed. American courts have either refused to believe that the beneficiary of a self-settled offshore asset protection trust is unable to repatriate assets:

> [I]t defies reason – it tortures reason – to accept and believe that the debtor transferred over $7,000,000 in 1991, an amount then constituting over ninety percent of his liquid net worth, to a trust in a far away place administered by a stranger – pursuant to an Alleged Trust which purports to allow the trustee of the Alleged Trust total discretion over the administration and distribution of the trust res. The Court declines to abandon common sense and to torture reason in the manner urged by the debtor.[271]

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270 What state's law applies is a topic beyond the scope of this paper. Suffice to say that there are several leading theories, including [1] the law of the jurisdiction with the greatest degree of contact with the transaction, Kaiser Steel Corp. v. Jacobs (*In re* Kaiser Steel), 87 B.R. 154, 159 (Bankr. D. Colo. 1988), [2] the law of the jurisdiction where the transferred property is located -- mandated in some states if they property is realty, Citizens Bank of Clearwater v. Hunt, 927 F.2d 707, 710 (2d Cir. 1991), or [3] that law which most benefits creditors, Day, *Solution for Conflict of Laws Governing Fraudulent Transfers: Apply the Law that was Enacted to Benefit the Creditors*, 48 BUS. LAW. 889 (1993).

271 *In re* Lawrence, 238 B.R. 498, 500 (Bankr. S.D.Fla. 1999), *aff'd*, 279 F.3d 1294 (11th Cir. 2002). Lawrence had set up an offshore trust in Jersey (later moved to Mauritius) and transferred $7 million to the trust immediately after losing a $20 million arbitration award to Bear, Stearns & Co. s*ee also* FTC v. Affordable Media, LLC (*In re* Anderson), 179 F.3rd 1228 (9th Cir. 1999). The Andersons had established a Cook Island Trust to receive millions of dollars in fees reaped from illegal Ponzi scheme. They had reserved the right, under the trust agreement, to change trustees and to change beneficiaries. The court refused to believe that they lacked power to repatriate funds even though trust agreement had a clause which precluded trustee from following their orders after the commencement of litigation against them:

or held that the impossibility of repatriation is not a defense.[272] In either case, the client ends up in jail, and there's nothing he can do about it. Except, maybe, sue the lawyer who set up the scheme in the first place and assured him that the impossibility of repatriating assets would shield the assets without subjecting him to jail time.

In some instances, both client and lawyer can go to jail. Defrauding creditors can be a crime under numerous state and federal laws.

1. Federal Crimes.

Title 18 of the United States Code, chapter 9 details a variety of crimes tailored specifically to the bankruptcy context. These criminal provisions may be violated by anyone who engages in the prohibited actions (not only debtors). They mirror similar provisions in section 727 of the Bankruptcy Code which deny the debtor a discharge when the debtor (and in this case only the debtor or in some cases his agent) undertakes certain prohibited actions relating to the concealment of assets, failure to maintain records and false oaths.[273]

The prohibited conduct, not surprisingly, in every case involves actions taken either directly or indirectly to defeat the Bankruptcy Code's purpose of equitable distribution to creditors of the debtor's assets, by securing to one party in interest a greater recovery than it is entitled by means of fraud or perjury.

Clause 7 of 18 U.S.C. § 152 imposes a fine of up to $5,000, or a five-year prison term, or both, for, a person who:

> 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, ...[274]

Section 152's principal objective is to prevent and punish efforts by a debtor to avoid distribution of any part of a debtor's estate in accordance with the Bankruptcy Code.[275]

> An old adage warns that a fool and his money are easily parted. This case shows that the same is not true of a district court judge and his common sense.

Id. at 1231.

272 *In re* Lawrence, 251 B.R. at 652 n. 18. The court specifically adopts Judge Cristol's legal analysis and findings on the defense of impossibility . . . . Judge Criston stated, in part, ... While impossibility is a recognized defense to a civil contempt order, the law does not recognize the defense of impossibility when the impossibility is self created." *Id.*, *see also id*. at 652 *citing* Pesaplastic C.A. v. Cincinnati Milacron Co., 799 F.2d 1510, 1521 (11th Cir. 1986) ("[W]here the person charged with contempt is responsibly for the inability to comply, impossibility is not a defense . . ."), Chicago Truck Drivers v. Brotherhood Labor Leasing, 207 F.3d 500, 506 (8th Cir. 2000).

273 *See* 11 U.S.C. §§ 727(a)(2), (a)(3), (a)(4).

274 18 U.S.C. § 152.

275 Stuhley v. Hyatt, 667 F.2d 807, 809 n.3 (9th Cir. 1982).

However, it has been used to convict non-debtors, like the lawyer for an insolvent corporation who arranged to transfer assets for less than fair value to a new corporation for the benefit of creditors who were also his clients.[276] Although the Bankruptcy Code's fraudulent transfer section voids only those transfers that take place in the year preceding the bankruptcy case, transfers more than a year before the case may still be criminal under 18 U.S.C. § 152 cl. 7.[277] The relevant statute of limitations is instead set forth in 18 U.S.C. § 3282, which requires an indictment or information within five years of the transfer.[278] With respect to the offense of concealment of assets, the five-year limitations provision must be read together with 18 U.S.C. § 3284, which provides that where concealment of assets in a bankruptcy is alleged, the statute of limitations begins to run from the discharge of the debtor.[279]

The criminal code thus produces an anomalous result: a client in a standard UFTA state with a four-year statute of limitations on the recovery of fraudulent transfers can transfer his cash to a Cook Islands trust four years before his bankruptcy case and escape civil liability, but he remains liable under the *criminal* code for a transfer that cannot be recovered under civil law!

Transfer of ownership and control of a debtor corporation without notice to creditors or bankruptcy court approval was deemed a fraudulent transfer of property of the debtor's estate under the criminal bankruptcy fraud statute.[280] Knowledge and intent are elements of the crime of illegally transferring and concealing assets in contemplation of bankruptcy.[281]

Other criminal statutes often pled in conjunction with the Bankruptcy Crimes Act include conspiracy to defraud the United States under 18 U.S.C. § 371, and mail and wire fraud under 18 U.S.C. §§ 1341, 1343. The conspiracy statute was used to convict a lawyer who hid from his client's creditors kickbacks from his client's liquidation sale.[282] The mail and wire fraud statutes are scarily broad:

> **§ 1341. Frauds and Swindles**
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or

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276 United States v. Switzer, 252 F.2d 139 (2d Cir. 1958).

277 United States v. West, 22 F.3d 586, 589-90 (5th Cir. 1994).

278 *See* 2A COLLIER ON BANKRUPTCY,¶ 29.14 at 1231 (J. Moore & L. King, 14th ed. 1983).

279 *See*, *e.g.*, United States v. Gleave, 786 F. Supp. 258, 266 (W.D.N.Y. 1992), *rev'd in part on unrelated grounds*, 16 F.3d 1313 (2d Cir. 1994).

280 United States v. Goodstein, 883 F.2d 1362 (7th Cir. 1989). In *Goodstein*, the transfer of ownership and control of the debtor resulted in a merger and, therefore, the transfer of the debtor's assets as well.

281 United States v. Martin, 408 F.2d 949, 953-54 (7th Cir. 1969).

282 United States v. Brown, 943 F.2d 1246, 1250-52 (10th Cir. 1991).

attempting so to do, places in any post office . . . any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier . . . .shall be fined under this title or imprisoned not more than five years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

§ 1343. Fraud by Wire, Radio or Television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined or imprisoned not more than $1,000 or imprisoned not more than five years, or both. If the violation affects a financial institution, such person shall fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

The "fraud" requirement of the mail and wire fraud statutes is construed more broadly than common law fraud.[283] It includes "conduct which fails to match the 'reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of the members of society'".[284] As noted above, courts in the context of civil RICO actions have held that a fraudulent transfer satisfies the "fraud" requirement of these statutes.[285]

The Bankruptcy Crimes Act used to be the only federal statute that specifically criminalized fraudulent transfers.[286] In 1994, however, Congress made it a felony punishable by five years imprisonment "corruptly to place (or endeavor to place) an asset or property beyond the reach" of the FDIC.[287] It has long been a fraudulent transfer under state civil law for a person to impoverish himself through gratuitous transfers for the purpose of becoming poor enough to qualify for medicare.[288] In 1996, Congress appeared to make it a federal crime.[289]

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283 United States v. Bishop, 825 F.2d 1278, 1280 (8th Cir. 1987); United States v. McNeive, 536 F.2d 1245, 1247-50 (8th Cir. 1976).

284 United States v. Bishop, 825 F.2d at 1280, *quoting*, Blachly v. United States, 380 F.2d 655, 671 (5th Cir. 1967), *cert. denied*, 389 U.S. 944 (1967).

285 United States v. Bishop, 825 F.2d at 1280 (8th Cir. 1987); Fortney v. Kuipers, 2001 U.S. Dist. LEXIS 19806, *8-*10 (Nov. 30, 2001); Cadle Co. v. Schultz, 779 F. Supp. 392, 399 (N.D. Tex. 1991).

286 United States v. Carman, 577 F.2d 556, 564-65 (9th Cir. 1978) (holding that an interstate fraudulent transfer of money did not violate 18 U.S.C. § 2314, which makes criminal the interstate transportation of "securities or money, of the value of $5,000 or more, knowing the same to have been stolen, converted or taken by fraud"). The Ninth Circuit reasoned that § 2314 criminalizes a taking from an owner, whereas a fraudulent transfer is a taking from a creditor. *See id*.

287 18 U.S.C. § 1032(3). However, a party with no duty to report assets to the FDIC does not commit a crime under this statute if he fails to do so. United States v. Seitz, 1997 U.S. Dist. LEXIS 777 Criminal No. 96-272-2 slip op. (E.D. Pa. Jan. 29, 1997).

288 Waukesha County Dept. of Social Servs. v. Loper, 53 Wis. 2d 713, 193 N.W.2d 679 (1972); Bandas v. Emperor, 121 Misc. 2d 192, 467 N.Y.S.2d 749 (Sup. Ct. Cayuga County 1983).

289 42 U.S.C. § 1320a-7b(a)(6), enacted in the Health Insurance Portability and Accountability Act, Pub. L. 104-191, § 217, 110 Stat. 1936 (1996). However, no penalty is set forth for the transfer or disposal of

Finally, there is the Internal Revenue Code with its own well known criminal provisions, including the following:

§ 7201. Attempt to Evade or Defeat Tax.

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony . . .

§ 7206. Fraud and False Statements.

Any person who--

* * *

(4) Removes, deposit or conceals, or is concerned in removing depositing, or concealing, any . . . property upon which levy is authorized by section 6331, with intent to evade or defeat the assessment or collection of any tax imposed by this title

* * *

shall be guilty of a felony . . . .

Query: does the transfer of assets to an offshore asset protection trust qualify as tax evasion or the removal of property subject to levy? Tax evasion is usually thought of as involving a false tax return, but it can involve transferring assets. That much is clear from decisions interpreting similar language in section 523(a)(1)(C) of the Bankruptcy Code, which excepts from discharge a tax "which the debtor . . . willfully attempted in any manner to evade or defeat".[290] Most courts have held that fraudulent transfers by debtors attempting to prevent *collection* of a tax -- in one case fraudulent transfers to a family trust -- also constitute attempts to "evade or defeat" the tax.[291] As noted above, there is *dicta* in a civil tax case to the effect that a taxpayer can intend to hinder, delay or defraud the United States before a tax is owed.[292]

2. State Crimes.

Several states have joined the federal government in making certain fraudulent transfers criminal.

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assets. Landsman & Klein, *The Criminalization of Transfers for Medicaid Eligibility*, 2 J. ASSET PROTECTION No. 3, 10 (Jan./Feb. 1997).

290 11 U.S.C. § 523(a)(1(C).

291 *See In re* Sumpter, No. 94-1439/94-1440, slip op. at 7 (6th Cir. Aug. 22, 1995) and cases cited therein; *In re Jones*, 116 B.R. 810, 814-15 (Bankr. D. Kan. 1990). *But see In re* Gathwright, 102 B.R. 211 (Bankr. D.Or. 1989) (evidence regarding any willful attempt to evade or defeat payment of tax is not relevant to a determination of non-dischargeability).

292 *See* Wagner v. C.I.R., TC Memo 1958-112, 1958 WL 1181 (Tax Ct.), 17 T.C.M. (CCH) ¶ 569, 17 T.C.M. (CCH) ¶ 949, T.C.M. (P-H) 58,112 (Tax Ct. 1958), *aff'd*, 279 F.2d 12 (7th Cir. 1960).

Alabama, Delaware, Kentucky, New Jersey and New York have each enacted a penal code provision against "Fraud in Insolvency", providing in relevant part:

> A person is guilty of fraud in insolvency when, with intent to defraud any creditor and knowing that a receiver or other person entitled to administer property for the benefit of creditors has been appointed, or that any other composition or liquidation for the benefit of creditors has been made, the person
>
> (1) Conveys, transfers, removes, conceals, destroys, encumbers or otherwise disposes of any part of or any interest in the debtor's estate . . ..[293]

New York has additional provisions governing fraud involving security interests, mortgages and installment sale contracts:

> **Fraud Involving a Security Interest: Penal Law § 185.05**
>
> A person is guilty of fraud involving a security interest when, having executed a security agreement creating a security interest in personal property securing a monetary obligation owed to a secured party, and:
>
> 1. Having under the security agreement both the right of sale or other disposition of the property and the duty to account to the secured party for the proceeds of disposition, he sells or otherwise disposes of the property and wrongfully fails to account to the secured party for the proceeds of disposition; or
>
> 2. Having under the security agreement no right of sale or other disposition of the property, he knowingly secretes, withholds or disposes of such property in violation of the security agreement.[294]

The crime of fraud involving a security interest is a "very rare misdemeanor".[295]

> **Fraudulent Disposition of Mortgaged Property: Penal Law § 185.10**
>
> A person is guilty of fraudulent disposition of mortgaged property when, having theretofore executed a mortgage of real or personal property or any instrument intended to operate as such, he sells, assigns, exchanges, secretes, injures, destroys or otherwise disposes of any part of the property, upon which the mortgage or other instrument is at the time a lien, with intent thereby to defraud the mortgagee or a purchaser thereof.[296]

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293 Code of Ala. § 13A-9-48; 11 Del. C. § 892; Title L. Ky. Penal Code, Ky. Rev. Stat. § 517.090; N.J. Stat. § 2C:21-13; N.Y. Penal Code § 185. There are few decisions interpreting any of these statutes. *See, e.g., Powell v. Criminal Court*, 44 Misc. 2d 838, 255 N.Y.S.2d 1, 1 (Sup. Ct. 1964) ("The unusual nature of the criminal charge, and the fact that Section 1170 of the Penal Law [N.Y. Penal Code § 185's predecessor] is rarely used does not mandate a finding that it should not be used more often").

294 Penal Law § 185.05.

295 *See* People v. Stavrinoudis, 154 Misc. 2d 887, 586 N.Y.S.2d 865, 866 (Dist. Ct. 1992). In *Stavrinoudis*, one of the very few reported decisions mentioning this crime, the court held that the defendant's bankruptcy discharge did not preclude prosecution. *Id.* at 866-67.

296 Penal Law § 185.10.

An essential element of this crime is to dispose of the property with intent to defraud the mortgagee or purchaser thereof.[297] Where a defendant, through a corporation in which he was principal, executed a mortgage prior to acquisition of the property described therein, and when the property was subsequently acquired, disposed of the property without satisfying the mortgage and prior to its recordation, defendant could be convicted of fraudulent disposition of mortgaged property.[298]

Fraudulent Disposition of Property Subject to a Conditional Sale Contract: Penal Law § 185.15

> A person is guilty of fraudulent disposition of property subject to a conditional sale contract when, prior to the performance of the condition of a conditional sale contract and being the buyer or any legal successor in interest of the buyer, he sells, assigns, mortgages, exchanges, secretes, injures, destroys or otherwise disposes of the goods subject to the conditional sale contract under claim of full ownership, with intent thereby to defraud another.[299]

Oklahoma law provides that any person who is party to any conveyance or assignment made with intent to hinder, delay or defraud creditors, and every person being "privy to or knowing" of such conveyance, "who willfully puts the same in use as having been made in good faith," is guilty of a misdemeanor.[300]

California criminalizes fraudulent transfers in two provisions of the Penal Code. Section 531 of the Penal Code provides:

> Every person who is a party to any fraudulent 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, or to defeat, hinder, or delay creditors or 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.

As indicated above, Penal Code § 531 is often cited in disciplinary actions by the California State bar against attorneys who participated in a scheme to defraud creditors.[301]

Section 154 of the California Penal Code provides as follows:

> (a) Every debtor who fraudulently removes his or her property or effects out of this state, or who fraudulently sells, conveys, assigns or conceals his or her property with intent to defraud, hinder or

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[297] *See*, *e.g.*, People v. Scala, 113 N.Y.S.2d 902, 904 (N.Y. Mag. Ct. 1952) (court found no intention to defraud where evidence showed that defendant disposed of property for junk only, without profit to defendant and without concealment).

[298] People v. Prince, 110 Misc. 2d 55, 441 N.Y.S.2d 586 (Sup. Ct. 1981).

[299] Penal Law § 185.15.

[300] 21 Okl. St. § 1671.

[301] *See*, *e.g.*, Allen v. State Bar of Cal., 20 Cal. 3d 172, 570 P.2d 1226, 1229; Townsend v. State Bar of Cal., 32 Cal. 2d 592, 197 P.2d 326, 329 (1948).

delay his or her creditors of their rights, claims, or demands, is punishable by imprisonment in the county jail not exceeding one year, or by fine not exceeding one thousand dollars ($1,000), or by both that fine and imprisonment.

(b) Where the property so removed, sold, conveyed, assigned, or concealed consists of a stock in trade or a part thereof, of a value exceeding one hundred dollars ($100), the offense shall be a felony and punishable as such.[302]

An act which is done with intent to defraud creditors is necessarily fraudulent, and hence, if the word "fraudulently" were omitted from section 154, prescribing the punishment for one "fraudulently" removing, selling, conveying, assigning, or concealing property with intent to defraud, hinder, or delay his creditors, the remaining parts of the section would completely define the offense sought to be prevented.[303] A transfer made with actual intent to defraud creditors is void for illegality as to any creditor and may be attacked by any creditor, whether an existing or a future creditor.[304] If actual intent is established, the fact that the transferee gave consideration is immaterial.[305] There are very few reported decisions discussing prosecutions under this section.

The California Penal Code does not define "debtor". "Debtor" is defined, however, in Civil Code § 3429 as "one who, by reason of an existing obligation, is or may become liable to pay money to another, whether such liability is certain or contingent" -- a much broader definition of "debtor" than that contained in the Bankruptcy Code which requires a person to have commenced a bankruptcy case in order to be a debtor.[306]

3. <u>The Assets Can Run, But the Client Can't Hide</u>.

The first thing the Client may say (or think) is that creditors may never even find out about the transferred assets. He is wrong.

First, the IRS: Anyone with money offshore has to report it on his or her tax returns. Failure to report offshore bank accounts on a tax return is a misdemeanor punishable by one year in jail.[307] For these reasons, the first thing lenders generally ask of troubled borrowers is their tax returns.

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302 Section 155 of the California Penal Code is very similar to this section, but instead proscribes the fraudulent removal, concealment or disposition by a *defendant* or *judgment debtor* of personal property sought to be recovered.

303 People v. Waller, 64 Cal. App. 390, 222 P. 171 (1923).

304 Heffernan v. Bennett & Armour, 110 Cal. App. 2d 564, 584, 243 P.2d 846, 859 (1952).

305 *Id.*

306 11 U.S.C. § 109.

307 Failure to supply information is a misdemeanor punishable by a fine of up to $25,000 ($100,000 in the case of a corporation) and imprisonment under 26 U.S.C. § 7203. Filing a false tax return is a misdemeanor punishable by a fine of up to $10,000 and imprisonment under 26 U.S.C. § 7207.

Second, the lenders: Troubled borrowers are almost always asked to fill out extensive disclosure documents as part of a work-out with their banks. Those documents always require disclosure of transfers without consideration. If the client fails to disclose his offshore trust or his transfers in a report to a lending institution with federally-insured deposits, he has "knowingly made a false statement or report" punishable by a fine of up to $1,000,000 and/or a prison term of up to 30 years.[308] Moreover, if the client is dealing with a matter within the jurisdiction of any department or agency of the United States, and he "knowingly and willfully" fails to report the existence of his offshore trust, he has made a "false ... or fraudulent statement[] or representation[]" and may be fined up to $10,000 or imprisoned for up to five years.[309]

Finally, the bankruptcy court: if the client becomes a debtor in a bankruptcy case, he has to file statements of his financial affairs on Official Forms prescribed by the Judicial Conference of the United States pursuant to Federal Rule of Bankruptcy Procedure 9009. Official Form No. 6 (Schedules of Assets and Liabilities) requires the client to disclose all bank accounts (Schedule B Item 2) and all "contingent and noncontingent interests in estate of a decedent, death benefit plan, life insurance policy or trust (Schedule B Item 19). Official Form No. 7 requires the client to disclose all transfers out of the ordinary course of their business or financial affairs during the year prior to his bankruptcy petitions (Item 10). Failure to disclose either the offshore asset protection trust or the transfers made within the year is a bankruptcy crime under 18 U.S.C. § 152 cl. 3 punishable by a fine of $5,000 or five years' imprisonment.

4. Criminal Exposure of the Lawyer.

The lawyer cannot be held liable, criminally or otherwise, if the lawyer advises the client in good faith on the limits of the law and the client then acts on such advice.[310] However, if the lawyer participates in the client's criminal conduct, "the role of lawyer gives no occupant of it any criminal law immunity," and "[t]he fact that the lawyer's part in the criminal enterprise was an otherwise traditional lawyerly function, such as advice giving or legal drafting, also does not immunize the lawyer from criminal responsibility."[311]

The question remains: what constitutes "participation" by a lawyer?

Lawyers are prosecuted for participating in crimes with their clients both when they aid and abet the crimes and when their "participation" in the crime is that of a co-conspirator.

For federal crimes, aiding and abetting is generally prosecuted under 18 U.S.C. § 2, which provides:

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308 18 U.S.C. § 1014.

309 18 U.S.C. § 1001. *See also* United States v. Wright, 988 F.2d 1036, 1038 (10th Cir. 1993) (agency has jurisdiction when it has power to exercise authority in particular situation).

310 G. Hazard Jr. & W.Hodes, The Law of Lawyering: A Handbook on the Model Rules of Professional Conduct § 1.1:205 at 18.29 (2d Ed. 1997 Supp.).

311 WOLFRAM, *supra* n.160, § 13.3.2 at 692-693.

(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

(b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.

To prove aiding and abetting, the government must prove, beyond a reasonable doubt, that the defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed."[312]

That formulation clearly covers attorneys who draw papers to effectuate their clients' crimes. In *United States v. Arrington*,[313] the Fourth Circuit held that an attorney for the buyer of stolen goods could be convicted of aiding and abetting the theft where he knew the goods were stolen, prepared the bill of sale, advised one of the thieves to forge another thief's signature to the bill of sale, notarized the bill of sale, approved (on behalf of his client, the buyer) title documents he knew were bogus and released from his client's escrow account the funds needed to buy the goods. The court held:

To be convicted of aiding and abetting, "participation in every stage of an illegal venture is not required, only participation at some stage accompanied by knowledge of the result and intent to bring about that result." *United States v. Hathaway*, 534 F.2d 386, 399 (1st Cir. 1976).[314]

United States v. Picciandra[315] upheld the conviction of a lawyer for aiding and abetting a client's income tax evasion where the lawyer did nothing more than [a] disburse client funds believed by him to be "legal" (but in fact obtained in criminal transactions) from the lawyer's escrow account and [b] review and send to his client income tax forms that the lawyer knew, based on directions from his client, were false.[316]

A number of cases involve attorneys' participation in various schemes to obtain citizenship for immigrants not legally entitled to that status. Those cases in some significant respects parallel the offshore asset protection field, because in both contexts, the attorneys have the expertise and promote their services to the clients (or to other schemers who find the clients), who are for the most part ignorant of the issues and the possibilities, however illegal, before the attorneys educate them.

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312 United States v. Peoni, 100 F.2d 401, 402 (2d Cir. 1938) (L. Hand, J.).

313 719 F.2d 701 (4th Cir. 1983).

314 *Id*. at 704.

315 788 F.2d 39 (1st Cir. 1986).

316 The Court of Appeals sustained the trial court's instruction to the jury that it could infer from the evidence that Lucid "deliberately refused to enlighten or to take notice of a certain fact" in believing Picciandra's representation that the shopping bags full of money were legal: "Any reasonable person would have realized that in today's society the bizarre bearing of shopping bags filled with large sums of cash signaled some form of illegal activity." 788 F.2d at 46. The corollary here, of course, is that no attorney selling offshore asset protection trusts to clients can shut his eyes to the client's presumed intent in creating such trusts.

For example, in *United States v. Sarantos*,[317] Sarantos was an attorney charged with, *inter alia*, aiding and abetting others to make false statements to the INS in violation of 18 U.S.C. § 1001 and § 2. Sarantos and one Makris participated in a scheme to obtain permanent residence for male Greek aliens by causing the Greeks to engage in sham marriages with United States citizens. Makris arranged the sham marriages, and Sarantos prepared the visa petitions for the alien spouses which represented that the couples were living together as husband and wife. Sarantos also advised the wives to tell the INS that they were living with the husbands, but not to tell the INS they had been paid to enter into the marriages. It is significant that the government did not prove that Sarantos was explicitly told that the couples were not in fact living together; it did prove that he knew that the marriages were shams by proving that in some cases the newlyweds required an interpreter because they did not speak the same languages, and in others that divorce papers were executed simultaneously with the immigration papers.

The court sustained the trial court's instruction to the jury that Sarantos could be found guilty of aiding and abetting if they concluded that he acted "with reckless disregard of whether the statements made were true or with a conscious effort to avoid learning the truth," even if the jury found that he was not "specifically aware of the facts which would establish the falsity of the statements."[318]

When the government believes the attorney's role in the criminal scheme is greater than that of an aider and abetter, it generally indicts the attorney as a co-conspirator. "The essence of the crime of conspiracy is an agreement to commit an unlawful act."[319] However, the line between aiding and abetting and conspiracy is not always easy to determine. For example, *United States v. Lofton* was brought under the criminal RICO statute, 18 U.S.C. § 1962. Eleven defendants were charged in that case with, *inter alia*, using funds obtained from a pattern of racketeering enterprises (including narcotics transactions) to invest in certain enterprises engaged in interstate commerce. Socolov, the attorney, was charged under the RICO conspiracy section, 18 U.S.C. § 1962(d): the government alleged that he knew that the principal perpetrators had obtained their income from racketeering activities and counseled, facilitated, aided and abetted them in using and investing that income in the enterprises in question: "What Socolov is charged with is assisting [the principal perpetrators] in making investments when it was illegal for them to do so."[320] However, a review of the actions with which Socolov was charged do not suggest a materially greater involvement in the crime than Picciandra's role, as discussed above, who was charged merely with aiding and abetting.

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317 455 F.2d 877 (2d Cir. 1972).

318 *Id*. at 897. *See also* United States v. Maniego, 710 F.2d 24 (2d Cir. 1983) (attorney convicted of aiding and abetting in conspiracy to present false documents to INS on behalf of participants in sham marriages); United States v. Meadows, 540 F. Supp. 490 (S.D.N.Y. 1982) (relating to pretrial discovery motions in connection with an indictment of an attorney for, *inter alia*, mail and wire fraud and aiding and abetting the submission of false statements to obtain Social Security Cards).

319 United States v. Loften, 518 F. Supp. 839, 851 (S.D.N.Y. 1981), *aff'd*, 819 F.2d 1130 (2d Cir. 1987) (citations omitted).

320 *Id*. at 854.

Socolov moved to dismiss the indictment, arguing, *inter alia,* that he could not be liable either as an aider and abetter or a co-conspirator because he did not have racketeering income himself which he invested in the enterprises. The Court denied his motion, holding that one need not be either a principal or an accessory to be guilty of conspiracy under section 1962(d); it was enough to sustain the indictment that the government represented that it would prove at trial that Socolov knew the client's income was derived from racketeering sources before he gave his investment advice.[321]

Another noteworthy case is *United States v. Haimowitz.*[322] Haimowitz's client was a convicted felon who wanted to obtain a liquor license to use in a restaurant he had opened. Haimowitz's efforts were devoted to assisting the client to obtain the license. In furtherance of that goal, Haimowitz advised his client to purport to transfer the restaurant to his wife, and to represent to the state that he and his wife were separated and soon to be divorced (a representation Haimowitz knew to be false), and Haimowitz attempted to bribe a state senator with the client's money to obtain the liquor license.

The court easily dismissed Haimowitz's effort to justify his actions as required by his professional obligations to his client: "Haimowitz also contends that his professional obligation as an attorney compelled him to act as he did. The Court disagrees that an attorney's professional obligations require him to engage in crime with his client."[323]

Finally, consider *United States v. Popkin*[324] -- not a straight aiding and abetting or conspiracy case, but one with clear relevance to the asset protection bar. Attorney Popkin was charged with "corruptly obstruct[ing] and imped[ing] and endeavor[ing] to obstruct and impede the due administration of Title 26, United States Code, by preparing [tax returns which misrepresented the source and amount of his client's income] and by creating a California corporation for [his client] to disguise the character of illegally earned income and repatriate it from a foreign bank" under 26 U.S.C. § 7212(a).[325] Section 7212(a) makes it a crime, *inter alia*, "corruptly or by force" to "obstruct or impede[], or endeavor[] to obstruct or impede the due

321 The *Socolov* case demonstrates, by contrary example, that relatively few cases against attorneys for aiding and abetting or conspiracy with their clients can actually be brought, for failure of proof. Socolov contended that the wiretaps of his conversations with the principal perpetrators should not be admissible on the grounds that they represented privileged communications. The Court disagreed, holding that his advice was in the nature of business advice, not legal advice. It noted, however, that it would in general be difficult to build a conspiracy case against an attorney for activities with or in regard to clients, because of the attorney client privilege. It was possible in *Lofton* case only because of the wiretaps, which permitted the government to dispute the claim of privilege and to argue that Socolov's advice was not generally legal but was rather in the nature of investment and business advice. It is interesting to consider whether all of the advice given in regard to establishing an offshore asset protection trust would be protected by the attorney/client privilege, or whether a fair amount of it would instead be considered to be more in the nature of business advice about investments.

322 725 F.2d 1561 (11th Cir. 1984).

323 *Id*. at 1571, n.10.

324 943 F.2d 1535 (11th Cir. 1992).

325 *Id.* at 1536-37.

administration [of title 26]."[326] After a jury trial, attorney Popkin was found guilty and sentenced to one year and a day in prison and ordered to pay restitution of $4,755.

On appeal, Popkin contended that the evidence below had not shown that he had acted corruptly.[327] The circuit court held:

> Popkin acted corruptly, moreover, because at least one intent in creating the corporation was to secure an unlawful benefit for his client. The purpose of the corporation went beyond repatriating money held in a foreign bank. It provided a means, in creating a paper loss from inter-corporate transactions, by which the funds held abroad and repatriated appeared to be less than the actual amount of untaxed money that [the client] should have reported for 1983 and 1984.[328]

The court pointed to the fact that the client had approached Popkin for advice on how to minimize his tax exposure, because the client did not himself know of a method to do so.[329]

A detailed exploration of the degrees of lawyer conduct that constitute permissible lawyering as opposed to impermissible assistance in a criminal act is beyond the scope of this paper, but it probably is not necessary in the context of the offshore asset protection trust. The offshore asset protection trust is the lawyer's product; he sells it to his client, just like the lawyer who sells the arranged marriage to illegal immigrant. If the lawyer knows the arranged marriage is criminal, he commits a crime by advising his client to marry. So too, if the lawyer knows that the offshore asset protection trust would be criminal, the lawyer's suggestion that the client establish the trust is also criminal.

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326 *Id.* at 1537.

327 Popkin also contended that the statute required an allegation and proof of force or threats of force directed at a specific agent or employee of the government. The court rejected that contention. *Id.* at 1539.

328 *Id*. at 1540.

329 *Id*.

IV. THE LAWYER AND THE CLIENTS.

Return now to our three hypothetical clients: the Guarantor, Developer and Doctor. Should the lawyer open an offshore asset protection trust for any of them?

A. The Guarantor.

The Guarantor, it will be recalled, has guaranteed his business' loan from an FDIC-insured bank. If the Guarantor transfers substantially all his assets to an offshore asset protection trust and the business fails within the period for voiding fraudulent transfers, the bank will accuse the Guarantor of making a fraudulent transfer. As noted above, the lawyer will be subject to discovery because the attorney-client privilege will not apply, and discovery will show that the Guarantor transferred his assets to keep them out of the bank's hands. The bank may sue the lawyer, and it may complain to the bar.

The bank was a *present* creditor, not a future creditor, at the time of the transfer. If the lawyer practices in South Carolina, he can rely on the South Carolina ethics opinion cited above, which distinguishes not between "present" and "future" creditors but between likely judgments and unlikely judgments.[330] Other than that opinion, however, the law seems to be uniform that a transfer to hinder, delay and defraud a present creditor is unethical and subjects the lawyer to discipline. In the eight states recognizing aider and abettor/conspirator liability, the lawyer could be civilly liable. The bank could file a complaint with the United States Attorney's office accusing the lawyer and client of conspiring to commit wire fraud under 18 U.S.C. § 1343. Finally, if the bank has failed and the FDIC is suing the client and lawyer, the FDIC can complain that the offshore asset protection trust corruptly placed an asset beyond its reach -- a federal crime.[331]

B. The Developer.

The Developer, it will be recalled, fears that foreclosure of a non-recourse mortgage on his building will leave him with $25 million in phantom income and no cash to pay the tax thereon. The IRS is not a present creditor by any means: no tax is due on the day the Guarantor walks into the lawyer's office, and no tax will be due until April 15 of the year following the foreclosure. The likelihood of tax liability, however, is substantial.

The IRS is not an "unforeseen" creditor. It is a creditor *in prospect*. The lawyer knows the Developer is opening the offshore asset protection trust with the primary, if not the sole, purpose of shielding assets from a tax liability three years away. In these circumstances, the trust seems to be clearly in violation of the UFCA and UFTA. The Code, the Model Rules

[330] S.C. Bar Ethics Advisory Opinion 84-2 (undated), summarized in Collected Ethics Opinions, *supra* n. 165, at 1980-85 801:7912.

[331] 18 U.S.C. § 1032(2). However, a party with no duty to report assets to the FDIC does not commit a crime under this statute if he fails to do so. United States v. Seitz, 1997 U.S. Dist. LEXIS 777 Criminal No. 96-272-2 slip op. (E.D. Pa. Jan. 29, 1997).

and California's various provisions seem to prohibit the lawyer's involvement in the trust.[332] Finally, it is not impossible that the IRS -- faced with no assets to levy upon -- will seek criminal sanctions against client and lawyer. There is no case on point, but the Internal Revenue Code's criminal provisions seem broad enough to encompass a transfer made with intent to put assets beyond the reach of a tax claim that is in prospect.

C. The Doctor.

The Doctor is the "easiest" case: there are no present creditors to hinder, delay or defraud. The offshore trust is aimed at future, unknown and undesired malpractice creditors. As noted above, I believe the fraudulent transfer laws protect such creditors from transfers specifically aimed at them as a category, but this is clearly an area where the law is unsettled. Plaintiff's counsel will have to create new law to hold the Doctor's lawyer either liable or accountable to his bar association.

332 *See, e.g.,* Boid v. Dean, 48 N.J. Eq. 193, 3 Dick. 193, 21 A. 618 (Ch. Ct. 1891) (person about to slander ex-partner could not transfer assets to render himself judgment proof prior to committing tort).

V. CONCLUSION

I am a bankruptcy lawyer, so I apologize to the estate planning lawyers who will bridle at my uneducated understanding of their practice, but it seems to me that estate planning is a game.[333] The taxing authorities set out an obstacle course for the client seeking to save taxes, and the lawyer helps maneuver around the obstacles.

The law of fraudulent transfer is not like that at all. It embodies a moral principle: Thou shalt not cheat thy creditors. Thus I doubt that the law of estate planning contains anything like the following peroration:

> Whoever suffers, the principles of justice must prevail. He who is not willing to do all for his wife and children does not deserve to be called a man, but he cannot favor even those so near to him with intent to deprive his creditors of what is their due. Men will leave their wives and children, become exiles from home, leaving their dearest ones within the enemy's lines, risk their lives in battle, all to protect and uphold the rights of man; then would they not rather that they and their families should even want than to inflict injustice upon their creditors? Better, far better, suffer even the privations of life, relying upon the humanity of mankind, than by devices and fraud keep from others what is due them.[334]

One does not have to endorse the foregoing quote (which predates the adoption of stable bankruptcy laws) to recognize the moral impetus behind it.

It is true that an individual can make provision for his family, gifts to his friends and contributions to his charities, even if such transfers turn out, with hindsight, to prejudice future creditors. This is a natural consequence of the free alienability of property and even of the concept of private property itself.

Nor do I join in Professor LoPucki's lament for the "Death of Liability"[335], where he condemns secured loans, "asset securitizations", sale and leasebacks, leveraged buyouts and the like as defeating the ability of judgment creditors to recover. All of those vehicles benefit third parties – the secured creditors who will (or have) extended credit, the shareholders who will (or have) invested equity in a business. Advantaging one set of creditors over another is a preference, not a fraudulent conveyance, and a preference is not a moral wrong. Distributions to shareholders is a fraudulent conveyance, but If American law wishes to protect shareholders in leveraged buyouts, it can do so.[336]

But offshore asset protection trusts are different because they serve to preserve the debtor's interest in his own assets. There is no public policy that allows a debtor to retain the benefit and control of assets that are not available to his creditors. It is no answer to rejoin that

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333 My former trusts & estates partner Joel Levin preferred to describe estate planning as an "art."

334 Lockhard & Ireland v. Beckley, West Virginia Supreme Court of Appeals, January 1877 Term, 87, 109 (April 28, 1877).

335 106 Yale L. J. 1 (1996).

336 *See* 11 U.S.C. § 546(e).

American law allows liability shielding devices such as corporations, limited partnerships, limited liability companies and homesteading or asset exemptions. What American law gives to creditors, American can take away – and the aforementioned liability-avoiding methods are all subject to the fraudulent conveyance laws in any event.

But where an offshore asset protection trust is set up for the explicit purpose of shielding assets from future creditors in a manner invalid under American law, there is no reason to protect the trust from the reaches of the fraudulent transfer law, and every reason to scrutinize the culpability of the lawyer whose idea it was in the first place.

There are many countries where citizens routinely stash their assets abroad. It will be a shame if the United States joins their ranks. I predict that American courts will not let that happen without a fight. The lawyers who make it possible – indeed, who encourage it – will not be viewed favorably in the battles to come.