

## Asset-Protection Planning Ethical? Legal? Obligatory?

It's all of the above

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**F**Professional advisors to high-net-worth individuals have responded to our society's perceived litigiousness by developing a subset of estate-planning services known as asset-protection planning—that is, planning designed to place assets beyond the reach of potential creditors.<sup>1</sup> But some professionals, particularly lawyers, question whether they should be assisting clients in such an endeavor. Specifically, they question whether asset-protection planning is ethical or even legal. (See, “Shelter From the Storm,” page 38.)

These are compelling issues for today's estate planning practitioner. Yet many aspects of even a traditional estate plan may be characterized as asset-protection planning. Consider, for example, limited partnerships or limited liability companies created not only for valuation discounts but also

to insulate assets from potential liabilities arising from ownership of real estate. Similarly, a trust by its very nature can offer protection from a beneficiary's creditors, though it might have been established for other purposes.

Still, a line does need to be drawn. On the one side is legal and ethical asset-protection planning that serves merely to protect against the possibility of creditors in the future. On the other side is planning that serves to defraud existing or probable future creditors. The most important question, then, is: Where to draw this line?

A line needs to be drawn. On one side: legal and ethical asset protection.

### IN GENERAL

No attorney ethics rule directly discusses asset-protection planning. Instead, ethics opinions issued by some state bar and local bar associations on

asset-protection planning have looked to the prohibition against attorneys advising or otherwise assisting clients in transfers that may later be found to have been a fraudulent conveyance. Of course, non-lawyer estate-planning professionals are not bound by attorney ethics rules. But they would be wise to heed them, because such rules provide a likely gauge for their own professional ethics standards.

Ten states follow the American Bar Association's Model Code of Professional Conduct (promulgated in 1980), which warns that a lawyer shall not "engage in conduct involving dishonesty, fraud, deceit, or misrepresentation".<sup>2</sup> A corollary in the model code, DR 7-102, "Representing a Client Within the Bounds of the Law," says a lawyer should not "counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent."<sup>3</sup> Although the model code does not define what is meant by the terms "illegal" or "fraudulent," at least one model-code jurisdiction, New York, has provided that the term fraud "does not include conduct, although characterized as fraudulent by statute or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another."<sup>4</sup> Therefore, in New York and by extension in other model-code jurisdictions, the absolute prohibition on an attorney counseling or assisting a client in perpetrating a fraud would not necessarily proscribe an attorney from counseling or assisting a client in transferring property that may later be determined to have been a fraudulent conveyance.<sup>5</sup>

The rest of the states and the District of Columbia follow the ABA's Model Rules of Professional Conduct (promulgated in 1983). The model rules similarly define the terms fraud and fraudulent as "conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information."<sup>6</sup> It would seem that an attorney practicing in a model-rules jurisdiction can ethically counsel or assist a client in transferring property pursuant to an

asset-protection plan without fear that the client's transfer may later be determined to have been a fraudulent conveyance.

### CASES AND ETHICS OPINIONS

Only a few courts and state and local bar ethics opinions have ever applied these ethics standards to the transfer of property for an avowed asset-protection planning purpose. Although these opinions are not binding in a subsequent disciplinary proceeding, they often are instructive to an advisor contemplating potentially unethical conduct and persuasive to a disciplinary panel or court adjudicating the propriety of such conduct *ex post facto*.

So what have these ethics opinions said? In Connecticut Informal Opinion 91-23,<sup>7</sup> an attorney requested an opinion about whether a lawyer could ethically recommend and/or assist a client in transferring a client's jointly owned home to his wife when the client had substantial debts beyond his ability to repay. Basing its opinion on Model Rules 1.2(d) and 4.4, and in certain limited circumstances, 8.4(c), the Connecticut Bar Association's Committee on Professional Ethics opined: "A lawyer may not counsel or assist a client to engage in a fraudulent transfer that the lawyer knows is either intended to deceive creditors or that has no substantial purpose other than to delay or burden creditors."<sup>8</sup>

The committee explained: "Whether or not a particular transaction is a fraudulent transfer as a matter of substantive law is not the decisive factor in applying the Rules. The decisive factors are whether the lawyer knows that the transfer constitutes conduct having a purpose to deceive (see Rule 1.2(d)) or whether in counseling or assisting the client the lawyer is using means that have no substantial purpose other than to embarrass, delay or burden third parties (see Rule 4.4)."<sup>9</sup> The committee summarized: "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."<sup>10</sup>

In contrast, because the model code prohibits an attorney from counseling or assisting a

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client in conduct that is simply illegal, though not necessarily criminal,<sup>11</sup> Connecticut Informal Opinion 91-23 further suggests that knowingly giving advice or otherwise assisting a client in effectuating a fraudulent conveyance would, in and of itself, constitute a violation of the model code.<sup>12</sup> This is an important distinction between the proscriptions of the model code and those of the model rules.<sup>13</sup> It is, however, notable that (notwithstanding the opinion of the Connecticut Bar Association) whether all fraudulent transfers are generally thought of as illegal is subject to dispute.<sup>14</sup> Consequently, effecting a fraudulent conveyance in a model code jurisdiction would not necessarily be ethically impermissible as an illegal act.

### EXISTING CREDITORS

Ethics Opinion 1993-1 of the Legal Ethics and Unlawful Practice Committee of the San Diego County Bar Association considered the extent to which a member of the State Bar of California could ethically advise or otherwise assist a client avoid existing and identifiable creditors' rights. The committee there held that an attorney could not furnish advice or institute asset-protection techniques—unless the attorney did so in compliance with Rule 3-210 of the California State Bar Rules of Professional Conduct, "Advising the Violation of Law," which provides that a "member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule, or ruling is invalid." Moreover, as California has criminalized the act of causing a fraudulent conveyance,<sup>16</sup> the committee held that it would be a violation of the California State Bar Rules of Professional Conduct for the attorney to furnish advice or institute asset protection techniques where, as in the case before it, the client had existing and identifiable creditors.<sup>17</sup>

Beyond the effect of California's unique criminal statute, the committee

noted that, under State Bar Rule 1-100, "an attorney does maintain a duty to protect the public and to promote respect and confidence in the legal profession...At a minimum, the attorney's assistance with, and facilitation of the client's expressed, wrongful intent is intolerable as a matter of public policy."<sup>18</sup> It's important to note the facts upon which the committee opined involved existing and identifiable creditors. Where there are no such creditors and the client's expressed intent is not wrongful, there is no stated prohibition against asset protection planning in California, or elsewhere.

A 1984 opinion of the South Carolina Bar Ethics Advisory Committee specifically holds that it is ethical for an attorney to transfer a client's assets to protect against the potential claims of future creditors.<sup>19</sup> At issue was whether the model code (which governed professional ethics in South Carolina at the time) prohibited an attorney from transferring a client's property from the client's name to his spouse's name in anticipation of the possibility of a judgment being entered against the client. The committee held that such conduct for the sole purpose of avoiding an immediate reasonable probability of judgment would be in violation of DR 7-102(A)(7). But the committee also said, "The critical issue would be whether or not the transfer took place with a reasonable prospect that a judgment would be obtained against the client, or whether or not the transfer took place to avoid some possibility in the distant future...If...there does not exist the immediate reasonable prospect of a judgment being entered against the client, the transfer merely to avoid the future possibility of an action by a creditor or creditors would not be in violation of DR 7-102(A)(7)."<sup>20</sup>

Moreover, in what might be thought to be an implicit acknowledgment that asset-protection planning is ethical except where it also occasions a fraudulent conveyance

because of the immediate reasonable prospect of a judgment being entered against the client, the State Bar of California Committee on Professional Responsibility and Conduct has declined to rule on two requests for ethics opinion involving questions similar to the one at issue in Ethics Opinion 1993-1. In one such refusal, the committee explained that it "continue[s] to believe that this matter is primarily a legal matter rather than an ethics matter."<sup>21</sup>

The California committee's position is, of course, consistent with the general rule that an owner of property has an almost absolute right to dispose of his property in any manner he sees fit, restricted only by the fact that such transfer cannot be made to the injury or prejudice of certain (but by no means all) existing creditors. Consider for example, the U.S. Supreme Court's decision in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*<sup>22</sup> The court, in determining that the U.S. district courts do not have the equitable power to grant pre-judgment attachment to a creditor, stated: "The rule requiring a judgment [before attachment would be allowed] was a product, not just of the procedural requirements that remedies at law had to be exhausted before equitable remedies could be pursued, but also of the substantive rule that a general creditor (one without a judgment) had no cognizable interest, either at law or in equity, in the property of his debtor, and therefore, could not interfere with the debtor's use of that property."<sup>23</sup>

### OBLIGATION TO CLIENTS

The Supreme Court has stated that "the duty of the lawyer, subject to his role as an 'officer of the court,' is to further the interests of his clients by all lawful means."<sup>24</sup> Similarly, Model Code, DR 7-101, "Representing a Client Zealously," says: "A lawyer shall not intentionally fail to seek the lawful objectives of his client through reasonably available means permitted by

law and the Disciplinary Rules, except as provided by DR 7-101(B).<sup>25</sup> Interestingly, the model rules contain no comparable provision; closest is Comment [1] to Rule 1.3, Diligence, which says: "A lawyer shall act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf." In fact, an attorney's obligation to zealously represent his or her client has been cited under the law of at least one state, Connecticut, as the basis for negating civil liability for aiding a client's fraudulent transfer.<sup>26</sup> In *Suffield Development Associates Ltd. Partnership v. National Loan Investor*, the court found: "Protecting professional conduct from...liability ensures that no attorney is discouraged from intentional and aggressive actions, believed to be in the interest of a client, by fear of being held liable."<sup>27</sup>

So far there are no reported ethics decisions or malpractice cases addressing whether a lawyer is obligated to promote a client's lawful asset protection plan. But it is only a matter of time before such claims begin to be heard.<sup>28</sup> Therefore, professionals should not shrink from asset protection. Handled responsibly, it should be as ethically and legally innocuous as any other type of planning. Certainly, to protect themselves, professional advisors must do their due diligence. At a minimum, they should follow established "know your client" procedures, conduct or obtain a solvency analysis of the client, review the client's circumstances—and always document that due diligence.<sup>29</sup> ■

#### Endnotes

1. Portions of this article are excerpted from Howard Rosen and Gideon Rothschild, 810-2nd T.M., *Asset Protection Planning*.
2. Model Code of Professional Responsibility DR 1-102(A)(4) (1980); See *In re Hockett*, 734 P.2d 877, 883 (Or. 1987).
3. Model Code of Professional Responsibility DR 7-102(A)(7) (1980).
4. New York Code of Professional Responsibility, Definition 9 (1990).
5. Compare, however, *In re Hockett*, supra at footnote 2: "We conclude that the accused's act of assisting his clients in 'fraudulent' transfers...was done with the intent to cheat creditors of their lawful debts. Such conduct is 'conduct involving dishonesty,' a violation of DR 1-102(A)(4)," suggesting that an attorney who knowingly assists a client in effecting a fraudulent conveyance has committed an ethical violation.
6. Model Rules of Professional Conduct Terminology (1983).
7. Connecticut Bar Association Informal Opinion 91-22 (Dec. 5, 1991).
8. *Ibid.* at 1.
9. *Ibid.* at 2.
10. Estate planning would likely be held to be a substantial purpose other than to delay or burden third parties within the meaning of Rule 4.4. See, for example, Connecticut Bar Association Informal Opinion 91-22 at 7 ("where there is a demonstrable and lawful estate planning purpose to the transfer Rule 4.4 would not, in our view apply."). Also, *In re Hockett*, supra at footnote 2, at 883 ("we cannot say that the accused's conduct in his handling of the [marital] dissolution cases [which were found to have involved fraudulent conveyances] 'serve[d] merely to harass or maliciously injure' the creditors. His conduct did harass and injure the creditors, but that was not his sole aim").
11. Model Code of Professional Responsibility DR 7-102(A)(7) (1980).
12. Accord, *In re Hockett*, supra at footnote 2, at 162 ("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).")
13. See, for example, Charles W. Wolfram, *Modern Legal Ethics*, p. 706, Section 13.3.9 (West Publishing, 1986) ("What of client conduct that violates the law of torts, contracts, property, or some other noncriminal law that does not deal with fraud? The answer to those questions is ambiguous under the Code. Under the Model Rules a lawyer who assists the conduct described definitely commits no professional offense.")
14. *Mack v. Newton*, 737 F.2d 1343, 1361 (5th Cir. 1984); *Elliot v. Glushon*, 390 F.2d 514, 516 (9th Cir. 1967).
15. Summarized in ABA/BNA Lawyer's Manual on Professional Conduct, 1001:1801, American Bar Association and The Bureau of National Affairs, Inc. (1991-1995).
16. Cal. Penal Code Section 531 (West 1999). See also, *Allen v. the State Bar of California*, 20 Cal. 3d 172, 178, 570 P.2d 1226, 1229, 141 Cal. Rptr. 808 (1977) ("Participating in a scheme to defraud creditors is a crime (Pen. Code Section 531) and properly subjects an attorney to disciplinary action.").
17. See, also, *Townsend v. State Bar*, 32 Cal. 2d 592, 197 P.2d 326 (1948) (attorney suspension for three years for transferring client's real property after learning of decision adverse to client since transfers were found to have been for the purpose of hindering, delaying and defrauding client's creditor and preventing recovery upon judgment).
18. See, Rules of Professional Conduct of the State Bar of California, Rule 1-100(A) (1988).
19. South Carolina Bar Ethics Advisory Opinion 84-02.
20. *Ibid.*
21. Ethics Opinion No. 92-0005 (Formerly 91-0004).
22. 527 U.S. 308, 319, 119 S.Ct. 1961, 1968, 144 L.Ed. 319, 338 (1999).
23. See also, *Credit Agricole Indosuez v. Rossyskiy Kredit Bank*, 94 N.Y.2d 541, 729 N.E.2d 683, 708 NYS2d 26 (NY Ct. of Appeals; 2000); *Jacksonville Bulls Football, Ltd. v. Blatt*, 535 So.2d 626 (Fla. 3d DCA 1988); *Van Royen v. Lacey*, 262 Md. 94, 101 (Md. Ct. of App. 1970).
24. *In Re Griffiths*, 413 U.S. 717, 724, 93 S.Ct. 2851, 2856, 37 L. Ed. 2d 910 (1973).
25. Model Code of Professional Responsibility DR 7-101(A)(1) (1980).
26. *Nastro v. D'Onofrio*, 263 F.Supp. 2d 446 (2003) ("[T]here is no...cause of action against an attorney for aiding a fraudulent transfer...To acknowledge this cause of action would be contrary to the Connecticut Supreme Court's reluctance to "impose liability when such liability had the potential of interfering with the ethical obligations owed by an attorney to his or her client.")
27. *Ibid.* Citing *Suffield Development Associates Ltd. Partnership v. National Loan Investors, L.P.*, 260 Conn. 766, 784 (2002).
28. For example, in the case of *In re Hockett*, supra at footnote 2, at 154, the Oregon Supreme Court, stated that "as the lawyer for Mr. Beecroft and Mr. Neptune, the accused's obligation was to protect them from the claims of creditors, to the fullest permissible extent."
29. A discussion of the potential for liability for civil conspiracy or aiding and abetting a fraudulent conveyance is beyond the scope of this article. See, however, Howard Rosen and Gideon Rothschild, 810-2nd T.M. at A-10, *Asset Protection Planning*.