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**A Lawyer's Responsibilities and Risks in Connection with
Asset Protection Planning; Focus on Fraudulent Transfers**

By

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A. INTRODUCTION

In implementing normal estate planning as well as specific asset protection strategies, lawyers frequently discuss with their clients the option of moving or re-titling assets. In most cases, the transfer of assets is designed to take maximum advantage of the estate tax exclusion (presently \$3.5 million), the annual exclusion and the opportunity to remove post-transfer growth of gifted assets from the taxable estate. In some instances, those transfers of assets will be considered due to concern about looming liabilities (e.g., potential or actual exposure to litigation). In others, the transfers will be considered in anticipation of possible future liabilities. However the issue of asset transfers arises, all asset transfers potentially bring into play the rights of creditors:

--In some circumstances, assets are moved from what might be called “safe” ownership to “creditor exposed” ownership (for example, from entires to sole ownership or from one spouse to another).

--In other cases, assets are moved from “creditor exposed” ownership to “safe” ownership (for example, when assets are moved from one spouse’s sole name into the name of the other spouse or into a self-settled asset protection trust).

In the first category of cases, the question for the lawyer is whether and to what extent the advice regarding the ownership changes included advice regarding the creditor-related consequences of the change. In the second category, the question is whether there has been a discussion regarding the potential risk that certain creditors may at some point seek to unwind those transactions so that the creditors can access those assets.

There is also a third category of situations—where there has been no discussion between the lawyer and the client regarding the exposure of assets to creditors, now and in the future, despite the availability of safe and proper methods for minimizing or eliminating the potential exposure of assets. A simple example is where an unmarried couple owning assets jointly in an entires jurisdiction decides to marry. In most jurisdictions, marriage does not immediately create entires ownership—there needs to be a new transfer to secure the necessary unities of title.

All of these situations require an understanding of the rules governing the conduct of lawyers and most of them require a thorough understanding of the federal bankruptcy law and state statutory procedures for creditors (or bankruptcy trustees) to satisfy claims against assets that a debtor has fraudulently transferred. Given the critical focus on fraudulent transfer issues, this outline will provide an overview of the law of fraudulent transfers so that practitioners can attempt to avoid the pitfalls that arise when a client seeks to protect his or her assets.¹ The outline will then focus on the rules governing the conduct of lawyers and will consider the application of these rules in the situations outlined above.

B. FRAUDULENT TRANSFER LAW - A BRIEF HISTORY

The Prefatory note to the Uniform Fraudulent Transfers Act,² provides:

The Uniform Fraudulent Conveyance Act³ was promulgated by the Conference of Commissioners on Uniform State Law in 1918. The Act has been adopted in 25 jurisdictions, including the Virgin Islands The Uniform Act was a codification of the “better” decisions applying the Statute of 13 Elizabeth. The English statute was enacted in some form in many states, but, whether or not so enacted, the voidability of fraudulent transfers was part of the law of every American jurisdiction. Since the intent to hinder, delay, or defraud creditors is seldom susceptible of direct proof, courts had relied on badges of fraud. The weight given these badges varied greatly from jurisdiction, and the Conference sought to minimize or eliminate the diversity by providing that proof of certain fact combinations would conclusively establish fraud. In the absence of evidence of the existence of such facts, proof of a fraudulent transfer was to depend on the evidence of actual intent.⁴

In 1979 the Conference appointed a committee to study the Uniform Fraudulent Conveyance Act (“UFCA”) and to draft a revision.⁵ In 1984, the National Conference of Commissioners on Uniform State Laws approved the Uniform Fraudulent Transfer Act (“UFTA”).⁶ Currently, forty-four jurisdictions, including the District of Columbia, have adopted the UFTA and two jurisdictions have maintained the Uniform Fraudulent Conveyance Act (“UFCA”).⁷

C. STRUCTURE AND ESSENTIAL ELEMENTS OF UFTA

Under the UFTA, a creditor may avoid a fraudulent transfer “to the extent necessary to satisfy the creditor’s claim.”⁸ The statute also permits other remedies, including attachment, injunction and appointment of a receiver.⁹

1. What are the Elements of a Fraudulent Transfer?

- a. The creditor must have a claim, which is defined as “[a] right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatched, disputed, undisputed, legal, equitable, secured or unsecured.”¹⁰
- b. The debtor must have made a transfer with respect to the asset.¹¹ In general, a transfer is made when the creditor cannot acquire an interest in the asset “that is superior to that of the transferee.”¹² Note that “a transfer is not made until the debtor has acquired rights in the asset transferred.”¹³ Consequently, it can be argued that valid disclaimers are not susceptible to fraudulent transfer actions¹⁴ because a debtor who validly disclaimed property never obtained an interest in that property. This is probably not

the law in Pennsylvania (and probably other jurisdictions).

- c. An asset means “property of a debtor” but specifically does not include: property to the extent it is encumbered by a valid lien; to the extent it is generally exempt under nonbankruptcy law; or an interest in property held in tenancy by the entirety to the extent it is not subject to process by a creditor holding a claim against only one tenant.¹⁵ The definition of asset brings into play the provisions of state law governing the exemption, or non-exemption, of various assets from the claims of creditors.
- d. The creditor must demonstrate that the transfer was fraudulent.¹⁶
- e. A creditor may establish that a transfer is fraudulent as to that creditor by showing either “actual intent to hinder, delay or defraud any creditor of the debtor” or constructive fraud.¹⁷
- f. Actual intent may be established by circumstantial evidence.¹⁸ The UFTA sets forth the following eleven factors (frequently referred to as “badges of fraud”) that the court may consider in determining whether the creditor had actual intent:
 - the transfer or obligation was to an insider;
 - the debtor retained possession or control of the property transferred after the transfer;
 - the transfer or obligation was disclosed or concealed;
 - before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
 - the transfer was of substantially all the debtor’s assets;
 - the debtor absconded;
 - the debtor removed or concealed assets;
 - 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;
 - the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
 - the transfer occurred shortly before or shortly after a substantial debt was incurred; and
 - the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.¹⁹