Estate Planning to Protect Assets From Creditors - Dancing On the Line Between Legitimacy and Fraud

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September 2021
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
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Overview

According to the U.S. Financial Education Foundation, it is estimated that over 40 million lawsuits are filed annually. Thus, for some persons, including farmers and ranchers, an important aspect of estate and business planning is asset protection. The goal of asset protection planning is to protect property from claims of creditors by restructuring asset ownership to limit liability risk in the event of a lawsuit. Done correctly the restructuring creates a degree of separation between the assets and their owner to properly shelter them from creditors.

A significant key to asset protection planning is timing. Once a lawsuit has been filed or is a substantial certainty to be filed with an anticipated adverse outcome for a client, it’s too late to start utilizing legal strategies to shelter assets from potential creditors. Civil and criminal liability is possible for all parties involved as well as malpractice liability for related ethical violations. A recent case illustrates the point.

Considerations when engaging in asset protection – it’s the topic of today’s post.

The Attempt To Shield an Iowa Farm From Creditors – Recent Case

Facts of the case. A recent federal court case from Iowa illustrates the serious problems that can result for parties and their professional counsel that engage in asset protection if not done properly. *Kruse v. Repp, No. 4:19-cv-00106-SMR-SBJ, 2021 U.S. Dist. LEXIS 114013 (S.D. Iowa Jun. 15, 2021),* involves three interrelated lawsuits. The plaintiff was injured in an automobile accident, which left her in need of 24-hour care likely for the rest of her life. The accident was Weller’s fault and, due to his experience as an insurance agent, he knew he would face a large claim for the plaintiff’s injuries. Weller told family members he feared losing the family farm as a result of the impending lawsuit. After determining his liability exposure exceeded his insurance coverage, he sought legal counsel to help him shelter the assets from a potential claim. Based on the initial legal advice he received, less than two months after the accident Weller transferred the farm and other assets into a revocable trust and made several cash transfers to family members exceeding $100,000. He notified the defendant bank that he had recently been found at-fault in a major motor vehicle accident and that he faced liability exposure that exceeded his insurance coverage. However, the bank began working with him to weaken the appearance of his financial condition.

After leaving his previous attorney when settlement negotiations broke down, Weller met the defendant attorney (Repp) two months before the personal injury trial was set to begin. Repp holds himself out having a practice focusing on estate planning and that he “counsels and advises clients with respect to the management of their wealth to minimize estate and inheritance taxes through the use of asset protection trusts.” Weller later testified at trial that he told Repp of his previous attempts to shield himself from judgment by transferring his assets to a revocable trust and making cash "gifts." To this end, Weller testified he went to Repp specifically because Repp holds himself out as an "asset protection attorney." Repp told Weller that his previous attorney had given bad legal advice and that the cash gifts were inappropriate transfers of wealth. Repp then created an LLC and had Weller transfer the farm to the LLC by quitclaim deed to protect it from the anticipated personal injury judgment. The deed was accompanied with a trustee's affidavit that Repp prepared and notarized stating that the Trust was conveying the real estate "free and clear of any adverse claim." This transaction was completed approximately one month before trial in the personal injury case was scheduled to begin.

State court judgment. The plaintiff was awarded approximately $2,557,100 million in damages in the personal injury lawsuit. Judgment was entered on May 1, 2015. In early 2016, Repp helped Weller prepare a financial statement reporting the value of the farmland as an LLC asset. The bank helped Weller refinance mortgages on the farm, which listed the farm as Weller's *personal* asset, and issued promissory notes that were secured by the mortgage. This led to the plaintiff suing Weller on March 3,2016, for fraudulent transfers intended to shield Weller's assets from the personal injury judgment. The state trial court determined that the LLC was formed with the intent to shield Weller's assets from the plaintiff levying her judgment lien against his real estate. The state trial court, on March 13, 2018, found in the plaintiff's favor and held that all assets of the LLC remained available to the plaintiff for satisfaction of the judgment.

Claims for personal liability and removal to federal court. The plaintiff sued the bank and Repp in early 2019, alleging that they both knowingly participated in Weller's fraudulent attempts to shield his assets from the plaintiff's judgment. Specifically, the plaintiff claimed that fraudulent transfers had been made under state law; that the defendants conducted or otherwise participated in the conduct of a racketeering enterprise with the purpose of defrauding the plaintiff; and that the defendants tortiously interfered with her ability to collect the personal injury award. The defendants removed the case to federal court and claimed that the undisputed facts entitled them to judgment as a matter of law on various claims. The federal court largely denied the defendants' claims in early 2020, and the case proceeded.

Under the fraudulent transfer state law claim, the defendants argued that the plaintiff could not prove that they knew of Weller's fraudulent intent or that they helped in his scheme to shield his assets from the plaintiff's judgment. The court strongly disagreed pointing to Weller's disclosures to the bank that he was at fault in a major motor vehicle accident and the bank's subsequent dealings. The trial court also noted that the bank allowed Weller to inconsistently classify the farm as both a personal and LLC asset. The court determined a factfinder could reasonably infer that the bank had knowledge of Weller's intent to defraud the plaintiff. The bank argued that the plaintiff did not show prejudice by reason of priority in interest. The court noted that the bank's argument was based on a false premise, and that prejudice may be shown if a debtor encumbers property to create the *appearance* of over-securitization. Thus, the court determined that because critical questions existed concerning the effect of Weller's refinancing with the bank, summary judgment under the fraudulent transfer claim was precluded.

RICO claim. The Racketeering Influenced and Corrupt Organizations Act (RICO) provides for criminal penalties and a civil cause of action for acts performed as part of an ongoing criminal organization. *18 U.S.C. §§1861-1868.* Under RICO, a person who has committed "at least two acts of racketeering activity" within a 10-year period can be charged with "racketeering" if the acts are related in a specified manner to an "enterprise." Those found guilty of racketeering can be fined up to $25,000 and sentenced to 20 years in prison per racketeering count. *18 U.S.C. §924; §1963.* In addition, the racketeer must forfeit all ill-gotten gains and interest in any business gained through a pattern of "racketeering activity."

RICO also permits a private individual "damaged in his business or property" by a "racketeer" to file a civil suit. The plaintiff must prove the existence of an "enterprise." There must be one of four specified relationships between the defendant(s) and the enterprise: (1) either the defendant(s) invested the proceeds of the pattern of racketeering activity into the enterprise; (2) the defendant(s) acquired or maintained an interest in, or control of, the enterprise through the pattern of racketeering activity; (3) the defendant(s) conducted or participated in the affairs of the enterprise "through" the pattern of racketeering activity; or (4) the defendant(s) conspired to do one of the first three. *18 U.S.C. §1962(a)-(d).* In essence, the enterprise is either the 'prize,' 'instrument,' 'victim,' or 'perpetrator' of the racketeers. *See [National Organization for Women v. Scheidler, 510 U.S. 249 (1994)](#).* RICO also allows for the recovery of damages that are triple the amount of the actual or compensatory damages.

Repp claimed that there was no common purpose among himself and Weller to constitute an associated in-fact enterprise, and if there was, that the enterprise required a common purpose that is fraudulent, illicit, or unlawful. He asserted that these elements did not exist. The court disagreed, expressing disbelief at the assertions, and noted that RICO liability is extended to those who play some role in directing the group to further its shared goals, unlawful or not, so long as those goals are carried out through a pattern of criminal behavior.

The court stated as follows:

“They nevertheless prepared legal documents transferring his [Weller’s] property to a corporate form that posed significant barriers to any recovery by Kruse, assisted Weller in the creation of financial statements that painted an inaccurate picture of Weller's finances, and defended the legality of the conveyances in court. In both cases, the facts are sufficient for a reasonable jury to find Defendants tacitly agreed to participate in Weller's scheme to defraud Kruse and conspired to further the purpose of a RICO enterprise.”

Thus, the court determined that sufficient evidence existed for a fact-finder to possibly infer that Weller, Repp and the bank shared an unlawful purpose to shield Weller’s assets from the plaintiff’s looming judgment.

The court further stated:

“…Repp changed the course of the effort to defraud Kruse and "joined in a collaborative undertaking with the objective of releasing [Weller] from the financial encumbrance visited upon him by [Kruse]'s judgment."… Reversing the mechanisms put in place by Weller's prior attorney, Repp organized Weller Farms, filed a trustee's affidavit that ignored Kruse's unliquidated tort claim, directed Weller to execute a quit claim deed conveying his real estate to the entity, and assisted Weller in preparing financial statements that embedded multiple "ambiguities" that devalued Weller's financial picture during settlement negotiations. [Repp} then defended the transactions in the fraudulent transfer action, devising a legal strategy in an attempt to persuade the state court to validate the transactions. In essence, Repp agreed Weller's previous efforts were inappropriate. All of his advice that followed was consistent with the expertise in asset protection that Repp, not Weller, possessed.”

The defendants also claimed that there was no pattern of racketeering activity and that they had not directed the conduct of the enterprise’s affairs. The court disagreed, noting that the evidence of three years’ worth of communications led to a reasonable inference that a pattern of racketeering existed. Repp also asserted that he provided nothing more than ordinary legal services such that his conduct played no part in directing the affairs of Weller or the LLC. The court again disagreed and determined that factual issues remained concerning whether Repp played some part in directing the affairs of Weller’s fraudulent scheme.

The court lastly noted that for liability to arise from a RICO conspiracy, the plaintiff only needs to establish a tacit understanding between the defendants for conspirators to be liable for the acts of their co-conspirators. The defendants argued they did not know the full extent of Weller’s fraudulent scheme and were mere scriveners of information provided by him. The court disagreed, stating as follows:

“They claim he was a mere scrivener of information provided by Weller and intended only to assist Weller in setting up a farming entity by which to bring his son into the family business. That characterization, in light of the circumstances surrounding his [Repp’s] relationship with Weller, present genuine factual issues and credibility determinations on whether Repp played "some part" in directing the affairs of Weller's fraudulent scheme and require a jury to resolve.”

The trial court determined there was a genuine issue of material fact as to whether the defendants knew of or were willfully blind to the scope of the RICO enterprise. Therefore, the trial court denied summary judgment on the RICO charges and determined the defendants' position was a question for the jury.

Tortious interference with economic expectancy. On the common law tortious interference claim, the defendants argued that the Iowa Supreme Court had not yet recognized tortious interference with an economic expectancy as a cause of action. The Second Restatement of Torts describes this action as, "one who intentionally deprives another of his legally protected property interest or causes injury to the interest." *Second Restatement of Torts §871.* A party that does this is subject to liability if the party's conduct is generally culpable and not justifiable under the circumstances. The court determined that although the Iowa Supreme Court had not yet considered this issue, it would likely recognize this tort as a prima facie tort in the context of fraudulent financial practices.

Repp argued that the plaintiff failed to show that his predominant intent in forming the LLC was to injure the plaintiff's property interest. However, the court noted that the majority rule governing a prima facie tort does not require that the defendant be motivated predominantly to injure the plaintiff. The court pointed out that the facts led to a reasonable inference that Repp knew the transfer of Weller's assets to the LLC would interfere with the plaintiff's collection efforts. The bank made a similar argument, which the court rejected, resulting in summary judgment on the tortious interference claim being denied. Thus, the jury will need to determine whether the defendants were more than mere scriveners, and thus subject to tort liability.

Note: It's important to remember that the case was positioned on a motion for summary judgment. That's a fairly low hurdle for the plaintiff to clear, especially when the evidence on such a motion is viewed in the light most favorably to the non-moving party (the plaintiff in the Iowa case).

Ethical Considerations

The asset protection legal field is fraught with ethical "landmines" for attorneys. I asked Prof. Shawn Leisinger, Associate Dean for Centers and External Programs at Washburn University School of Law to comment on some of the possible ethical issues involved in the Iowa case. Shawn teaches ethics at the law school and also sometimes makes ethics presentations at my events around the country. The following comments are his.

It is fairly well settled that attorneys generally, and certainly attorneys who specialize in taxation issues, may advise clients in the area of "tax avoidance" but must not have that same advice go over the line into "tax evasion." This concept frames the ethical guidelines that attorneys must consider when they work with their clients on asset ownership structuring, whether for tax or liability purposes. In the Iowa case, a fairly common business entity formation asset protection tactic arguably stepped over the line that falls in that gray area between avoidance and evasion.

While each state has its own version of ethical rules that the attorneys licensed their must follow, these rules generally incorporate or adapt what are known as the Model Rules of Professional Conduct promulgated by the American Bar Association. In the case at hand a number of these rules would warrant consideration but we only touch on a few of those that apply most directly here.

MRPC Rule 2.1: Advisor. Under this rule, attorneys are deemed to be counselors who are advised, "In representing a client, a lawyer shall exercise professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation." This rule is arguably permissive and would suggest that Repp should have had a candid conversation with the client about the steps being taken to protect the client's assets and the risks and realities of those steps. We are not privy to the private conversations that occurred in this case, however.

MRPC Rule 8.4: Misconduct. This rule sets forth the specific definitions of attorney misconduct that in turn warrant and could support attorney discipline under the rules. The rule provides, "It is professional misconduct for a lawyer to: … (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects; (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation; (d) engage in conduct that is prejudicial to the administration of justice; …".

While the "criminal act" under (b) might seem a higher bar to hit in the asset planning realm, as one reads the facts of the Iowa case it is fairly easy to conclude that the ***multiple*** steps taken by and with ***multiple*** parties to try to shelter the assets noted, and the continuing interaction with the bankers and others involved in the property transfers, hit either the disjunctive "dishonesty" or "misrepresentation" standards in section (c). I note section (d) as well due to the fact that in many of these kinds of cases a court may well conclude that the catch-all of "acts prejudicial to the administration of justice" certainly must define the actions if one might argue the other provisions do not fit.

From an ethical perspective one should also know that attorneys have an obligation to report unethical conduct of other attorneys under the rules. Rule 8.3 provides, "A lawyer who knows that another lawyer has committed a violation of the Rule of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority".

An important point to remember is that the ethical perspective on these cases is largely fact specific and subject to argument and interpretation of when and how that gray line may have been crossed.

Conclusion

To put the Iowa case in perspective and provide further guidance for others engaged in asset protection strategies, I asked Timothy P. O'Sullivan, a partner in Foulston Siefkin LLP, a law firm in Wichita, Kansas to comment. Among other things, Tim is a Fellow in the American College of Trust and Estate Counsel and is an adjunct professor of law at Washburn University School of Law. The following comments are his.

This Iowa decision puts into stark relief the personal and professional exposure asset protection attorneys may have when advising clients of estate planning techniques to protect their assets from creditor claims. Most estate planning attorneys whose practice extends into this area have given thought, but often not enough, to the possibility that they can be held in violation of attorney professional conduct rules by participating in or structuring a transaction that is a fraudulent conveyance by their clients, as well as risk possible personal liability for damages by an aggrieved creditor. Although there does not appear to be more than a modicum of cases to date imposing such liability against assisting third parties, such exposure is nonetheless present. The exposure may derive from a state's version of the Uniform Fraudulent Transfer Act, which has been enacted in the vast majority of states, which otherwise would not have included a remedy against a third party involved in the transaction.

As noted in the Iowa case, other potential legal authority for imposing personal liability rests more solidly and broadly under the federal RICO Act as an alleged "civil conspiracy," or (as the court also noted) an actionable tort by an aggrieved creditor under the Second Restatement of Torts for assisting in the fraudulent act. These principles extend well beyond applicable state law.

The potential liability of estate planning professionals generally requires not only that the creditor incur damages as a result, but also actual knowledge as to the principal purpose of the estate planning device used, and that the client had a debt (which need not be liquidated) the satisfaction of which would be avoided, delayed, or hindered by the implementation of a specific asset protection plan. The plan could be as simple as gifting assets away or it could be a plan to make the claim more arduous or unlikely to be satisfied, such as putting exposed non-exempt assets in an LLC or restructuring debt to the detriment of a claim by a creditor. All three of these strategies were present in the Iowa case. As noted by the court, there is no defense against the personal liability of an attorney that the attorney was a mere scrivener of his client's plan if the attorney is assisting in implementing a strategy that the attorney knows to be fraudulent.

For professionals engaging in asset protection strategies, there can be no more important prophylactic measure against professional liability exposure than gaining sufficient knowledge of the client, the client's assets and liabilities, and most importantly, determining *ab initio* whether the client is seeking advice as protection against a specific currently existing, or problematic current creditor. Perhaps the client is simply desiring to protect against potential future creditors in general due to the nature of the client's assets or personal, business or professional activities. If so, asset protection planning is entirely appropriate. But, determining the client's purposes up-front is a must.

The use of detailed salient client questionnaires and requisite financial statements that gather complete and relevant legal and financial information from clients is most desirable. Checking clients' references and gleaning knowledge of a client's background can also serve as valuable indicia in determining a client's honesty and intent in seeking asset protection advice. In all events, the attorney's engagement letter should make it clear that the attorney is relying on the accuracy of the client's disclosures and submitted information in recommending or implementing any asset protection plan and further clearly stating that the attorney will not participate, or continue to represent the client, in any plan that might constitute a fraudulent transfer.

Although the Iowa case involved a decision that denied summary judgment in favor of the defendants, the court's analysis of the legal underpinnings make it quite evident as to the third-party liability exposure of the defendants, including not only the debtor's attorneys involved in setting up the LLC, but also the debtor's bank in favorably restructuring the debtor's debt to the creditors' disadvantage, should the factual assertions of the plaintiffs be proven at trial.