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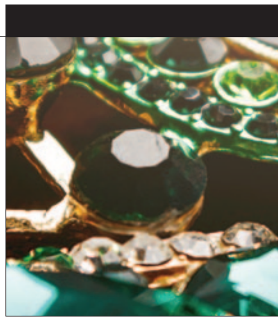

Estate Planning to Protect Assets From Creditors – Dancing On the Line Between Legitimacy and Fraud

Practitioners should be thoughtful of this useful but tricky area of planning.

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According to the U.S. Financial Education Foundation, it is estimated that over 40 million lawsuits are filed annually.[1] 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 there is a substantial certainty it will to be filed with an anticipated adverse outcome for a client, it is 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.

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 involves three interrelated lawsuits.[2] 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. 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 min-

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imize 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 schedule 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.

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.

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.[3]

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.[4] 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.[5] In addition, the racketeer must forfeit all ill-gotten gains and interest in any business gained

1 http://www.ogdenpage.com/frivolous_lawsuits.htm
2 No. 4:19-cv-00106-SMR-SBJ, 2021 WL 2451230 (S.D. Iowa Jun. 15, 2021).
3 Kruse v. Repp, 4:19-cv-00106-SMR-SBJ, 2020 WL 1317479 (S.D. Iowa Mar. 20, 2020).
4 18 U.S.C. sections 1861-1868.

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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.[6] In essence, the enterprise is either the 'prize,' 'instrument,' 'victim,' or 'perpetrator' of the racketeers.[7] 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:

> 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 defen-

5 18 U.S.C. sections 924 and 1963.
6 18 U.S.C. section 1962(a)-(d).
7 See *National Organization for Women v. Scheidler*, 510 U.S. 249 (1994).

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dants 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."[8] 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:

Remember that the case was positioned on a motion for summary judgment. That is 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 this case).

Ethical Considerations

It is fairly well settled that attorneys generally, and certainly attorneys who specialize in taxation 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 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 there must follow, which generally incorporate or adapt 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; this article touches on a few of those that apply most directly.

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. The private conversations that occurred in this case are unknown.

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). It is worth noting 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" could define the actions if one might argue the other provisions do not fit.

From an ethical perspective one should also note the 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 Rules 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."

Attorneys engaging in asset protection planning, whether for liability protection or estate planning purposes, should also always carefully determine who the client is.

In *Kruse v. Repp,* without knowing the content of personal conversations between Weller and his heirs, it is fair to assume that they may well have mutually spoken with Repp about the steps to be taken. In the real world of family farms, and family farm corporations, the mixture of family property and assets that move into and out of the farm operation make it so that these asset planning decisions may well involve discussions with multiple potential "clients" who may rely on the advice given. While simplistic, the general rule for the formation of an attorney client relationship is that the attorney provides "advice" and the "client" relies upon it. From a practice standpoint, attorneys in these situations should be very clear in conversations who they represent and supplement these clarifications with written correspondence to the actual client and family members when possible.

The attorney/client relationship here is crucial for determining the application of the ethical rules regarding conflict issues, especially in the realm of family farms that regularly feel that they have their "family attorney" to advise them as a group. MRPC Rule 1.7 deals with conflicts of interest with current clients and provides, "… a lawyer shall not represent a client if … there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibility to another client, a former client or third person …". MRPC Rule 1.8 provides specific rules with current clients and MRPC Rule 1.9 covers those obligations to former clients. Note as well MRPC Rule 1.10 that explains imputation of those conflicts especially to lawyers in the same firm.

Practitioners are encouraged to reread the rules as adopted in the applicable jurisdiction(s) along with the associated comments to keep a fresh perspective in these types of cases when that line becomes blurred. The *Kruse v. Repp* decision has immediate repercussions to the family farming operation since, in many cases, such planning strategically shifts substantial tax obligations to the heirs. In normal practice those heirs who may fail to follow the legal guidance provided, and start to look at substantial tax or other liability, may often be inclined to look to their "family lawyer" for fault and recompense.

It is an important point to remember that the ethical perspective for attorneys in these cases is largely fact-specific and subject to argument and interpretation of when and how that gray line of "tax avoidance" to "tax evasion" may have been crossed. With that said, however, it is plausible to take the position that an estate planning attorney could have a client duty to incorporate asset protection advice in standard estate planning for wealthy clients. Query whether the failure to provide such advice could give rise to a plausible malpractice claim if the client is later unnecessarily exposed to a liability event. But, the point remains, asset protection planning that is done upfront before the hint of an event that could give rise to a liability claim is prudent planning. Those, however, are not the facts of *Kruse v. Repp.*

Estate Planning

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Asset Protection Planning – Practice Protocols

The potential for professional liability. The 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 possibly a modicum of cases to date imposing such liability against assisting third parties, such exposure is nonetheless present. Such exposure could 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 decision, 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 focusing on the fraudulent conveyance itself.

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 purpose of the estate planning device used (which need not be predominant), 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 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 "mere scrivener" defense against the personal liability of an attorney if the attorney is assisting in implementing a strategy that the attorney knows to be fraudulent.

> **For professionals engaging in asset protection strategies, there is no more important prophylactic measure against professional liability or third-party exposure than "knowing your client."**

For professionals engaging in asset protection strategies, there is no more important prophylactic measure against professional liability or third-party exposure than "knowing your client" by gaining knowledge of the client's assets and liabilities and determining *ab initio* whether the client is seeking advice as protection against a specific currently existing or problematic potential creditor. This can start with the initial intake questionnaire, which most estate planning attorneys already employ, requesting the client list assets and approximate values in general categories, along with the potential client's income, debts, and liabilities, including mortgages. The questionnaire would also normally ask the client to list annual income. If the client has a recent financial statement, ask that it be included. It would also be helpful to ask the client on the questionnaire to briefly list the client's estate planning goals. Should such goal list asset protection as a goal, most particularly if as a priority, this would warrant further inquiry into the nature of such goal. 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 normally entirely appropriate. But determining the client's purposes up-front is a must. If it does not relate to a specific claim or claims, it should be noted in the client's records.

Nonetheless, if specific asset protection techniques are to be implemented attendant to the estate plan to protect against possible future claims (such as transfers to a spouse or irrevocable trusts or LLCs, or any other transfers detrimental to the interests of potential creditors), before doing so an additional questionnaire in the form of a client affidavit would be desirable to protect the attorney. The client affidavit informs the client it is incident to the attorney's ethical responsibilities. The affidavit should require the client to list any current or anticipated judgments, any current, ending, threatened, or potential claims of which the client has knowledge, and any contemplated or past bankruptcies of the client.

8 Second Restatement of Torts section 871.

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Confirmation of such information in the affidavit by checking pertinent judicial records and noting same in the files of the client would also be beneficial.

The use of such salient client questionnaires, client questioning, affidavits, financial statements, and independent checking of relevant legal and financial information from clients is of paramount importance in this perilous planning area. Further, checking clients' references with the client's consent and otherwise gleaning as much knowledge of a client's background and litigation involvement as possible without violating client confidentiality, e.g., through public records, can 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 (there was none used in the Iowa case) should make it clear that the attorney is relying on the accuracy of the client's representations, disclosures, and submitted information in recommending or implementing any asset protection component of the client's estate plan and further clearly stating that the attorney will not countenance, participate, or continue to represent the client in any plan that might constitute a fraudulent conveyance.

Although the Iowa case involved a decision that denied summary judgment to 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.

Note:

The Iowa case did not proceed to trial. A settlement for an undisclosed amount was reached between the plaintiff and Repp's law firm. While the law firm's insurer initially refused to provide coverage on the basis that Repp's conduct was intentional, the insurer ultimately did provide coverage. Ultimately, Weller's entire farm was liquidated to help pay the settlement amount. Not even the homestead was preserved.

Conclusion

Asset protection is an important part of the estate planning practice. As wealth increases, a client's desire to protect assets from creditors also increases. As noted above, attorneys have unique duties and responsibilities when counseling clients on asset protection strategies. As with other types of estate planning situations, an attorney has a duty to educate the client on available alternatives and the legal implications that flow from those planning options – the benefits and the limitations. In the asset protection realm, as with other aspects of estate planning, there is no "one-size-fits-all solution.

However, the stakes are high in asset protection planning and the risk of liability exposure to the practitioner are equally high. Thoroughly investigating why a client is seeking asset protection is a must, as is staying within the "guardrails" of acceptable, non-fraudulent planning techniques. In all events, a practitioner must get client communications in writing, beginning with the client engagement letter. In addition, timing is essential. Asset protection planning should be engaged in before a potential liability event for the client occurs. If the asset protection plan is put in place after the fact, as in *Kruse v. Repp*, a cascading waterfall of serious liability issues could inundate the practitioner. ■

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