

**THE APPLICATION OF THE TERMS “FRAUD” V. “FRAUDULENT TRANSFERS”
UNDER THE RULES OF ETHICS**

**By: Denis Kleinfeld
The Kleinfeld Law Firm**

- Brief History of Fraudulent Conveyance
- There is a Difference Between “Fraud” and “Fraudulent Conveyance”
- How is a Fraudulent Conveyance Action Brought?
- Computing Solvency
- Creditor Remedies
- Brief Overview of Ethics and Attorney Liability

THE APPLICATION OF THE TERMS “FRAUD” V. “FRAUDULENT TRANSFERS” UNDER THE RULES OF ETHICS

By: Denis A. Kleinfeld¹

AN INTRODUCTION AND SUMMARY

The American legal system is based on the adversarial system of law. The lawyer plays a role as an advocate in representing only one party in that system. Each party, however, has legal rights and each is entitled to fully utilize their full measure of those rights for their own benefit. Although an attorney is not a party to a legal action or transaction but is the representative of a party, nonetheless frequently the attorney for a party becomes the focal point for hostile feelings and claims of unethical behavior.

In *Pickard v. Maritime Holding Corp.*, 161 So 2d 239, 241 (Fla. 3d. DCA 1964) the court observed:

“It is recognized that an attorney acting under employment, at the direction of his client and a legal manner, is not liable for the consequences of his client’s actions. [citations omitted] thus, the question before us is whether there is sufficient evidence in the record upon which the jury could find that the attorney acted illegally or beyond his employment to secure an unconscionable advantage against the plaintiff. The action of an attorney frequently angers his client’s opponent because the attorney by his energy must advance his client’s cause at the expense of the opponent. It is not infrequent that persons who have lost a lawsuit because of actions undertaken by an attorney on behalf of his client have been unjustly dealt with by the attorney. Nevertheless, the advantage of the adversary system in securing a full disclosure of the facts to the courts is such that we must accept its disadvantages.”

It is within this adversarial system that the ethical rules come into play. One significant issue, which arises and is the focus of this paper involves the term “fraud” as used in the ethical rules. Does that term also encompass the transactional circumstances which employs the known terms of “fraudulent conveyance” or “fraudulent transfer” as those terms are defined under the Uniform Fraudulent Transfer Act, the Uniform Fraudulent Conveyance Act or similar remedy statute as applicable in a particular state or under bankruptcy law?

The American Bar Association Model Rules of Conduct (the “Model Rules”) provides in the Preamble that “A lawyer is a representative of clients, an officer of the legal system and a public citizen having special responsibility of the quality of justice.”²

As to the phrase “an officer of the Court”, this phrase is “merely suggestive of the close working relationship between judges and traditional court room practitioners and today lacks much definitive significance.”³ As applied to a lawyer representing a client in a court proceeding, the term

means that an attorney is licensed to represent a client in court. There are no additional duties imposed on the attorney as that would create an irreconcilable conflict of interest as to the lawyer's ethical responsibilities to the client⁴. Any other meaning would place that attorney in the role of being an ombudsman rather than a zealous advocate. The phrase has no relevance to representation not involving work in a courtroom.⁵

The term "fraud" is specifically used under the Model Rules. Under Rule 1.2(d) Scope of Representation, "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent" Model Rule 8.4(c) defines professional misconduct to include "engage[ing] in conduct involving dishonesty, fraud, deceit or misrepresentation". Model Rules 1.2(d) and 8.4(c) are the only references in the Model Rules to conduct of the attorney or client, which involves fraud.

The term "Fraud" or "Fraudulent" is specifically defined by the Model Rules⁶ as denoting "conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information." The definition makes no reference to a definition of a fraudulent conveyance or fraudulent transfer as applicable to the Uniform Fraudulent Transfer Act, Uniform Fraudulent Conveyance Act or similar statute. The definition appears to be in keeping with the understanding that the "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.⁷ Thus, the term "fraud" refers to the law of deceit and not other conduct which is described by statute or administrative rule.⁸

It is well settled that because of the adversarial nature of litigation and the duty for attorneys to zealously represent their clients with total loyalty and confidentiality, the concept of a lawyer lawfully providing services to a client having legal liability to a third party in contract, tort or for a fiduciary duty because of a client's conduct is virtually non-existent. Limited exceptions have been carved out in probate on the theory of a fiduciary duty involving wills and trusts cases in relation to deemed or intended third party beneficiaries. The general principle is that an attorney has no legal duty to a third party who is adverse to his client's interest. This impacts on the lawyer's duty of absolute loyalty to the client. As noted in ABA Model Rule 1.7 comment [4], "Loyalty to a client is also impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other responsibilities or interests". This then sets the stage to examine the issue as to whether there is an ethical duty by an attorney to a non-client when the attorney represents a client in the client's transfer of property which is later subject to the statutory remedy commonly referred to as a "fraudulent conveyance".

It is clear that recovery based on common law fraud under the law of deceit requires a finding of a misrepresentation and a detrimental reliance by creditors with the damage occasioned thereby. The party creating the fraud is a necessary party to the action. In an action filed under a fraudulent conveyance remedy no such circumstances exist. As discussed in this paper, fraudulent conveyance statutes are directed to extend the ability of a creditor to trace and recover property from a third party. For these purposes, the transferee holding the subject property or the property itself are the necessary parties to a fraudulent conveyance action. Essentially what is required is a showing of a transfer of property at an undervalue or in a specified manner that prejudices the creditor. The fraudulent conveyance statutes (UFTA or UFCA) in and of themselves do not contain any language

which creates a creditor's remedy for money damages against third parties and are not otherwise applicable against persons who are neither transferees of the assets nor beneficiaries of the conveyance. The transfer of freely alienable property, even if later potentially or actually subject to a fraudulent conveyance action, is not unlawful nor is it tortious. The underlying theory or premise of the fraudulent conveyance remedy is recession of the transfer not the creation of liability.

The litigation process as an adversarial proceeding not only may result in financial injury to the other or "adverse" party, but financial economic injury to the other party is the anticipated direct result of the process. Litigation is a win-lose situation not a win-win scenario. Nonetheless, the lawyer's ethical obligation is to assist the client and not to avoid the infliction of economic harm on adversaries. This is not to say that an attorney by other conduct may become a participant with his or her client by acting outside the scope of his or her representation. However, where the attorney is acting within the scope of his or her representation of the client, such as in preparation of documents and instruments, providing legal advice and acting as the client's representative which accompanies that representation (representation essentially is listening, speaking, reading and writing), there is no ethical liability to a non-client. Specifically, as to the transfer or conveyance of property, there is no ethical obligation to a non-client arising from the client's lawful conduct in the transfer of the client's freely alienable property. The lawyer representing the client in such lawful transaction is acting ethically within the Model Rules.

1. DISCUSSION OF COMMON LAW FRAUD

The law of fraud ("fraud") is derived from and defined under the common law of deceit. The terms "fraudulent transfer" and "fraudulent conveyance" are fraught with semantic confusion due to the similarity of the terms, but are defined by statute not by common law. They are concepts embodied in a statutory remedy by which a creditor may have a conveyance by a debtor set aside if it left the debtor insolvent.⁹ For example, the foundation of the action to redress a fraud is in the common *law* of tort and evolved gradually over a long period of time from ancient origins.¹⁰ Fraud implies moral turpitude, and fraudulent transfer, by accident or design, suffers guilt by association with the common law variety. The law of fraud and the statutory remedy of fraudulent conveyance are not the same.

Fraud encompasses and is also known more colorfully as the common law actions of "misrepresentation" and "deceit."¹¹ The definition used in Model Rule – Those actions bear a connotation that serves to stigmatize dishonest transactions and the use of trickery¹² to gain advantage over someone else.¹³ Throughout the long development of fraud as a cause of action there is no escaping the implication that moral turpitude is the basis for redress.¹⁴ Proving fraud universally has been held require a showing of the intention to deceive or to mislead,¹⁵ and bad faith is used as a *test* of fraud.¹⁶

Mere wrongful intent is not sufficient to determine liability for fraud - there must be an overt act and a party injured in the process.¹⁷ In other words, one must demonstrate at least the three elements common of every tort action: 1) existence of a legal duty from defendant to plaintiff, 2) breach of that duty, 3) and damage as the proximate result of the breach of duty.¹⁸ Put another way, beyond the evil state of mind or scienter, a plaintiff has to prove that the defendant made a false representation of material fact, which he knew to be false when made, upon which the plaintiff

reasonably relied, and as a result of which the plaintiff suffered damages.¹⁹ In such a case, a misrepresentation action would probably exist subject to plaintiff's ability to show reasonable reliance.²⁰

The exact formulation defining fraud and the number of elements employed in the definition show a *fair* amount of variation in the case law, having to do more often with how the elements are separated and counted,²¹ and in accordance with the particular court's desire to broaden or narrow application of the law.²² Each element must be supported by sufficient evidence.

Fraud may never be established by doubtful, vague, speculative, or inconclusive evidence.²³ One court described fraud as "kaleidoscopic, infinite" and went so far as to suggest that courts should reserve to themselves considerable license in defining and determining fraud in order to frustrate efforts by tort-feasors to circumvent the law.²⁴ Professor Prosser criticized indiscriminate use of the word "fraud" which makes its use so vague as to require definition in nearly every case,²⁵ and settled on the following essential elements of common law fraud: 1) a false representation of fact; 2) knowledge or belief that the representation is false; 3) an intention to induce another to act or refrain from action in reliance on the representation; 4) justifiable reliance by such person; and 5) damage resulting from such reliance.²⁶ Some states have resorted to statutory definition, typically codifying the common law.²⁷

Fraud renders invalid all transactions and contracts which occurred because of it,²⁸ even if they were valid in all other respects. This result follows from the voluntary nature of the contract and the underlying principle that a party cannot be held to have contracted if there was no assent.²⁹ As a rule, an agreement induced by fraud is not void, but voidable.³⁰ Nevertheless, some courts have gone further where the deception produces such an essential error as to negate the purpose for which the victim entered the contract. In such a case the contract may be deemed "void ab initio."³¹ In this regard, *fraud* can be seen as preventing actual consent, thereby having a similar vitiating effect to "mistake," "want of capacity,"³² "duress" and "undue influence."³³ These are all considered to be species of fraud.³⁴

It follows from the contract analysis that an appropriate remedy for transactions fraudulently obtained is setting aside the contract or reversing the transaction in order to restore the defrauded party to his prior condition.³⁵ In conjunction with rescission, he may recover money paid out, consideration for the contract, or recapture of property.³⁶ In the alternative, the defrauded party may elect to affirm the transaction, sue for the benefits to which he is entitled or *for* damages, and retain the consideration received.³⁷ A defrauded person can affirm and recover damages, or disaffirm and rescind (recovering his consideration), but cannot pursue both remedies.³⁸ Various refinements of the damage rule may be used, for example the "benefit of the bargain rule" or consequential damages.³⁹ Punitive damages may also be available where there is outrageous conduct or the wrongdoer is wanton, reckless, or shows spite, ill will, or reckless indifference to the interests of others.⁴⁰

An action for fraud at common law (sometimes called "actual fraud") implies an intent to do wrong.⁴¹ Nevertheless, exceptions are made when courts perceive that harm has arisen out of a "peculiar confidential relationship between the parties."⁴² Such cases are deemed "constructive fraud." Constructive fraud arises when one party in a transaction is seen to have a special duty to the

other because of his superiority of knowledge, position, or fiduciary relationship, and he exploits or abuses this position.⁴³ A special duty may be inferred from the disproportionate power and knowledge a large institutional bank or broker wields in relation to ordinary individuals;⁴⁴ the willingness of a seller to provide financing for a buyer as an indication of trust and confidence;⁴⁵ blood relations;⁴⁶ a partnership relationship.⁴⁷ In a constructive fraud situation, a negligent representation that a plaintiff believed and relied on to his detriment may be sufficient to allow a remedy.⁴⁸

What about failing to provide information - is it fraud? Whereas it is well established that actual fraud (as in intentional deception) or constructive fraud (as in negligent misrepresentation) are actionable at common law, simple nondisclosure ordinarily does not constitute actionable fraud;⁴⁹ nor is concealment of a material fact unless done in such a manner as to deceive and mislead.⁵⁰ Nondisclosure may be treated as fraudulent if some artifice or trick has been employed to prevent the representee from making further, independent inquiry.⁵¹

There also are constructive fraud type exceptions. For example, where one party has special knowledge not apparent to the other, and is aware that the other party is acting under a misapprehension as to the facts that would affect his decision.⁵² In other words, when the fraud-feasor is in a special position relative to the victim, i.e. he has a duty to disclose and there is an obligation to act in good faith. Even if a party owes no duty to disclose facts, should he voluntarily assume such a duty, then any "suppression or disguise of, or distraction from the truth" renders the matter actionable and the common law requires full disclosure.⁵³ If one undertakes to answer inquiries respecting facts related to the transaction, then he must disclose the truth.⁵⁴

2. DISCUSSION OF FRAUDULENT TRANSFER – A LEGAL REMEDY

Statutory attempts to protect a creditor's ability to recover a debt by voiding certain conveyances of debtor's property appeared in England as early as a 1376 Statute of Edward.⁵⁵ The Statute of Edward apparently addresses schemes to defraud creditors through collusion and by abusing the refuge afforded by franchises of the Church.⁵⁶ The statute is aimed at piercing sham transactions by which a debtor would purport to give away borrowed *assets* or collateral to the sanctuary of the Church in order to cheat his creditors (or king?) whilst retaining control and benefit from those assets. This is essentially garden-variety deception and moral turpitude here; in a word, fraud.

It is commonly accepted that the seed from which contemporary fraudulent transfer remedy statutes grew is the Statute of 13 Elizabeth enacted in 1570, supplemented by a later statute, 27 Elizabeth.⁵⁷ These were criminal statutes, aimed at actual fraud involving transactions "devised, and contrived of malice, fraud, covin, collusion or guile," but they go a step further in that they encompass conveyances "to the end, purpose and intent, to delay, hinder or defraud creditors..."⁵⁸ Proving "intent" was a significant hurdle. The courts created the "badges or indicia of fraud", including insolvency of the debtor, lack of consideration for the conveyance, the relationship between transferor and transferee, the pendency or threat of litigation, concealment, transfer of debtor's entire estate, retention by the debtor of control, and benefit or possession of the property, which presumptively showed "intent".⁵⁹

In the United States, the Statutes of Elizabeth were incorporated into state law, either by direct adoption or indirectly via the Uniform Fraudulent Conveyance Act (UFCA), which effectively codified decisions applying the Statute of Elizabeth, or the overhauled version of the UFCA renamed the Uniform Fraudulent Transfer Act (UFTA),⁶⁰ and § 548 of the U.S. Bankruptcy Code.⁶¹ Various other Federal statutes also have fraudulent transfer provisions modeled on UFTA and the Bankruptcy Code,⁶² including the “Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990” (the “Fraud Prosecution Act”),⁶³ and the “Federal Debt Collection Procedures Act of 1990” (the “Federal Debt Collection Act”).⁶⁴

In terms of relevant analysis and perspective, it should be understood that at the time of the passage of the Statute of Elizabeth, creditors were at a disadvantage as to debtors. The debtors were able to conceal assets such as livestock and other farm goods relatively easy. At that time, there was no Uniform Commercial Code which could provide for the filing of a securities interest, there were no land records which facilitated the filing of mortgages of record and there certainly were no credit reporting agencies. As a practical matter, creditors in the 1500’s were at a severe disadvantage as to the debtors. Providing the creditors statutorily with an additional remedy seemed to level the playing field. However, the situation has changed in this modern era. Not only are there extensive means of filing mortgages and other liens on land records, but the Uniform Commercial Code provides a means to give security interest in all types of property as well as notice to third parties. Additionally, the widespread use of credit reporting agencies provides extensive information for creditors on potential debtors. Insurance for liability had become so extensive that most activities exposed to liability can be covered by insurance. Additionally, the limitation of liability, unheard of in the 1500s, is now the sine qua non of legal practice with the rise of corporations, limited partnerships, limited liability companies and asset protection trust statutes.

The advantage of creditors has been recognized by some states such as Florida when the legislature repealed, as of July 1, 1993, the bulk transfer provisions under Chapter 676, which is Article 6 of the Uniform Commercial Code. Originally Article 6 was designed to protect against a fraudulent transfer of a specific kind - that is, a debtor selling substantially all of his or her business assets in one “bulk” sale and walking off with the proceeds. The legislature recognized that the benefit given to creditors under Article 6 was no longer worth the legal burdens, as most creditors covered their exposures by having a security interest filed under Article 9 of the Uniform Commercial Code as well as having insurance for the exposure to the risk of loss.

Fraudulent transfer law still operates to tilt the playing field to serve creditor interests perhaps unnecessarily. A transfer is deemed fraudulent even as to a creditor whose claim arose *after* the transfer was made if the debtor had actual intent to hinder, delay, or defraud any creditor of the debtor.⁶⁵

The concept of requisite intent has become rather attenuated over time. In the words of one federal court, “evil motive is not required. The requirement is merely “an intentional act prejudicial to creditors.”⁶⁶ However, intent becomes entirely irrelevant if the transfer is made without receipt of reasonably equivalent value in exchange and the debtor is technically insolvent.⁶⁷

Because proof of actual intent is often unavailable through direct evidence, courts have traditionally relied upon certain well-defined “badges or indicia of fraud” to presume “fraudulent

intent.”⁶⁸ Some Courts shifted the analysis of conveyances under their purview from inquiry into the debtor's intent to whether a creditor was unreasonably injured by the transfer.⁶⁹ In this regard, fraudulent transfer superficially resembles “constructive fraud” under common law principles which provides an avenue by which a creditor may obtain recovery absent a showing of wrongful intent or active deception. This is in contrast to an action for common law constructive fraud which presupposes a special relationship between the parties to a transaction that lends itself to exploitation of one party. Furthermore, constructive fraud operates like actual fraud in that it involves a detrimental reliance induced when one party exploits his superior position and breaches his duty to deal fairly. The injured party is, in effect, duped into a bad deal that he normally would not have entered into – proof of “duress,” “essential error,” or “want of capacity” – may overcome traditional defenses to upholding a contract. To have constructive fraud in the first place, there must be privity (direct or contractual contact between the parties), and mutual obligations of good faith, i.e. one party wronged by another.

Fraudulent transfer law is not concerned with the relationship of the parties or righting a wrong but is remedial. It is a tool for collecting money or for executing on a judgment. It is not a procedure for determining the liability of a debtor. Thus, the focus on solvency is: the debtor's financial ability to satisfy claimants who have already proved their debt. In fact the transfers in question are “fraudulent” to *third parties* outside of the particular transaction in question, and the “wronged” parties may not even be ascertainable at time of transfer. The “badges of fraud” primarily indicate that a transaction caused the transferor to become unable to pay current or future creditors.⁷⁰ Conversely, an action to set aside a transfer as fraudulent against creditors is likely to fail despite a showing of intent to hinder, delay, or defraud a creditor (the badges of fraud) if the transfer has left the debtor with sufficient assets to cover the claims against him.⁷¹

Consistent with its remedial purpose, fraudulent transfer law seeks to extend a creditor's reach to assets no longer in the debtor's possession, and can offer numerous specific remedies which may operate against strangers to the creditor-debtor dispute. For example, UFTA enables a creditor, broadly defined to include any person holding a claim, to: 1) have the *transfer* or obligation avoided or annulled to the extent necessary to satisfy the creditor's claim; 2) obtain an attachment or other provisional remedy against the asset transferred or other property of the transferee; 3) obtain injunctive relief against further disposition by the debtor or a transferee of the asset transferred or other property; 4) have a receiver appointed to take charge of the transferred asset or of other property of the transferee; 5) obtain the entry of a money judgment equal to the lesser of the value of the transferred asset or the amount of the creditor's claim; 6) obtain other relief as circumstances may require.⁷²

In the bankruptcy context, §548 of the Bankruptcy Code enables the bankruptcy trustee to avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor if the debtor was insolvent on the date such transfer was made or such obligation was incurred.⁷³ The creditor is limited in time to recover his money. Section 548(a) of the Bankruptcy Code impacts transfers made up to one year before bankruptcy.⁷⁴ Transfers made more than a year before bankruptcy can be reached by application of §544(b), which enables the trustee to avoid any transfer of an interest of the debtor in property that is voidable under applicable law by a creditor holding an unsecured claim allowable under §502.⁷⁵ “Applicable law” refers to the substantive law of the jurisdiction governing the property in question, i.e. the relevant state law,⁷⁶ which typically can be on

the order of four years.⁷⁷ Certain Federal statutes may go back further still.⁷⁸

Fraudulent transfer law affects the rights and liabilities of parties outside of the transactions in question. The statutes and case law are clear that it is a remedial legal device whose purpose is to furnish creditors with enhanced powers by which to collect judgments. A “fraudulent transfer” is not an equitable action arising out of a misrepresentation to the creditor and detrimental reliance by the creditor being the proximate cause of damage. Thus, it cannot be a tort under the American legal system. Since a transfer of good title to property is the prerequisite to triggering the right of a creditor to avail himself of the statutory remedy, a transfer cannot be unlawful. If it were, a further remedy by statute would not be needed.

On the contrary, common law fraud is a tort concerned with the parties’ privity to a contract or transaction. A common law action for fraud allows a transaction to be set aside, or damages to be obtained by one party who was injured by the other’s active deception. The implication is that the injured party was coerced or deceived into participating in a contract such that it should be deemed to have failed in its essentials. In some cases protection may be extended, absent deception, when a fiduciary relationship exists between the parties, and one of them exploited his position for advantage to the injury of the other. The purpose of righting a wrong explains the availability of punitive damages under state law.⁷⁹

3. CRIMINAL FRAUDULENT TRANSFER STATUTES.

Fraudulent concealment or transfer of property can carry criminal penalties for attorneys as well as clients and third parties under the bankruptcy code.⁸⁰ Practitioners who collaborate with a client in criminal activity may risk criminal prosecution under an assortment of other federal statutes.⁸¹

For example, the attorney should be wary of the Internal Revenue Code which can be used quite creatively as a snare. The omnibus clause of 26 USC Section 7212(a) which proscribes “corruptly obstructing or impeding” administration of the code has been employed to punish an attorney for setting up business entities to disguise illegal income and could be used to evade tax.⁸² *United States v. Popkin* concerns money laundering but regards a fact pattern not unlike what might be involved in a sophisticated asset protection plan.⁸³ The connection to “corruptly obstructing or impeding administration of the code” is so tenuous in *Popkin* as to suggest that the same provisions could be used to prosecute more garden-variety conveyances. *Popkin*, however, involved a sting operation wherein the attorney’s client informed the attorney that he wanted to repatriate drug money and the attorney suggested a money laundering scheme – the fact pattern reeked of malfeasance and contempt for the law.

Violation of state fraudulent transfer laws is a crime in some jurisdictions, notably California.⁸⁴ Section 531 and 531a of the California Penal Code for example, make it a misdemeanor for every person who is a party to any fraudulent conveyance or who, with intent to defraud, knowingly executes or procures another to execute, or files or procures the filing of any instrument purporting to convey property “knowing that the person executing the same had no right, title or interest in the property so purported to be conveyed.” (As a general principle a lawyer is a representative of a party but is not, by virtue of such representation a “party” to a transaction.) The

California statute is clearly limited, however, to property which the transferor had “no right, title or interest in the property....” Clearly, where the transferor has lawful title or property interest and has the right to transfer the property there is no violation. Criminal statutes must be carefully reviewed for their specific application to a particular factual situation.⁸⁵ It appears that the few other states that have criminal fraudulent conveyance law are limited in their application to the transfer of secured or mortgaged property.

Aside from criminal penalties and possible liability to creditors for damages, the attorney is exposed to discipline for violation of the rule of professional conduct against advising or assisting a client to engage in an illegal act.⁸⁶ Disciplinary action is available if an attorney is convicted of a criminal fraudulent offenses inside or outside the practice of law,⁸⁷ and participating with clients in proscribed criminal conduct can cause an attorney to incur sanctions.⁸⁸

4. UNDERSTANDING THE DIFFERENCE BETWEEN FRAUDULENT TRANSFER AND ACTUAL (COMMON LAW) FRAUD UNDER THE LAW OF DECEIT.

The Supreme Court’s decision in *Grupo Mexicano De Desarrollo, S.A., et al v. Alliance Bonde Fund, Inc., et al* (No 98-231 decided June 17, 1999) has resolved a number of issues in debtor-creditor conflicts.⁸⁹ This case involved an action for money damages and a preliminary injunction was sought to prevent a defendant from transferring assets. The plaintiff was an unsecured creditor who had not yet established a judgment. (The applicability of the case stems from the fact that the circumstances are similar to a typical fraudulent conveyance litigation case). The majority opinion by Justice Scalia specifically focused on the legal point of law that a District Court lacked the authority to issue a preliminary injunction preventing the petitioners from disposing of their assets pending adjudication of respondents’ contra-claim for money damages, because such a remedy was historically unavailable from a district court of equity. The respondents in this Supreme Court appeal alleged in their original complaint, as noted by Justice Scalia, that “GMD is at risk of insolvency, if not insolvent already; that GMD was dissipating its most significant asset the Toll Road Notes to the payment of their claims, and by its transfer to them of Toll Road Receivables; and that these actions would ‘frustrate any judgment’ respondents could obtain.” These are the kind of allegations and elements that are typical of a classic fraudulent conveyance claim.

The District Court entered an order finding that “GMD is at risk of insolvency if not already insolvent.....” that, in light of (petitioners) financial condition and dissipation of assets, any judgment (respondents) obtained in this action will be frustrated; that respondents had demonstrated irreparable injury; and that it was almost certain that respondents would succeed on the merits of their claims.” Therefore, the court issued its preliminary injunction and ordered the respondents to post a \$50,000 bond to enjoin the \$309 million to Toll Road Notes. On appeal the Second Circuit affirmed the District Court opinion. The Supreme Court, on appeal, reversed.

The majority opinion recognized that the equity jurisdiction of federal courts was established under the Judiciary Act of 1789 and the prerequisites of obtaining equitable remedies as well as the general availability of injunctive relief depended on these traditional principles of equity jurisdiction. Many, if not most, of the states of the United States have similarly adopted the common law in the

same manner under their states' statutes.

An *amicus curiae* brief filed by the United States contended that preliminary injunctive relief is analogous to the relief obtained in the equitable action known as a “creditors bill.” Their argument was that this remedy permitted a judgment creditor to discover the debtor’s assets, to reach equitable interests not subject to execution at law, and to set aside fraudulent conveyances. The Supreme Court stated that “it was well established, however, that, as a general rule, a creditor’s bill could be brought only by a creditor who had already obtained a judgment establishing the debt. The Court reiterated its understanding that it would follow the well-established general rule “that a judgment establishing the debt was necessary before a court of equity would interfere with the debtor’s use of his property.” (emphasis added)

Justice Scalia, for the majority, specifically rejected the counter arguments raised by the dissent by Justice Ginsberg as being an expansive view of equity. Justice Scalia stated “We do not question the proposition that equity is flexible; but in the federal system, at least, that flexibility is confined within the broad boundaries of traditional equitable relief. To accord a type of relief that has never been available before – and especially (as here) a type of relief that has been specifically disclaimed by longstanding judicial precedent – is to invoke a “default rule” not of flexibility but of omnipotence.”

The Court found that “Despite the dissent’s allusion to the ‘increasing complexities of modern business relations,’ and to the bygone ‘age of slow moving capital and comparatively immobile wealth,’ we suspect there is absolutely nothing new about debtors trying to avoid paying their debts or seeking to favor some creditors over others – or even about their seeking to achieve these ends through ‘sophisticated.... strategies.’” (This later statement was a clear reference to offshore asset protection trusts which had been raised by Justice Ginsberg).⁹⁰

The Court further found that “The law of fraudulent conveyances and bankruptcy was developed to prevent such conduct; an equitable power to restrict a debtor’s use of his encumbered property before judgment was not.” In footnote 7 Justice Scalia states that “Several states have adopted the Uniform Fraudulent Conveyance Act (or its successor the Uniform Fraudulent Transfer Act), which has been interpreted as conferring on a non-judgment creditor the right to bring a fraudulent conveyance claim. Insofar as Rule 18(b) applies to such an action the state statute eliminating the need for a judgment may have altered the common law rule that a general contract creditor has no interest in his debtor’s property. Because this case does not involve a claim of fraudulent conveyance, we express no opinion on the point.” Quite telling, however, is Justice Scalia’s view as expressed in Footnote 11 wherein he states that “There is nothing whatever wrong with respondents pursuing their own interest. Indeed, the fact that it is entirely proper and entirely predictable is the very premise of the point we are making: That this new remedy will promote unregulated competition among the creditors of a struggling debtor.” (emphasis added) A fair reading of the opinion indicates that the transfer by a debtor of freely alienable property is lawful and the creditors concomitantly are free to pursue their legal rights.⁹¹

One interesting aspect of the majority opinion is its rejection of the change in law in England with regard to Mareva Injunctions. It was noted that this was not the law prior to 1975 and that since the change in the law by the Court. “It is significant that, in England, use of the Mareva Injunction

has expanded rapidly. Since 1975 the English courts have awarded Mareva Injunctions to freeze assets in ever increasing sets of circumstances, both within and beyond the commercial setting to an ever expanding number of plaintiffs.” The majority opinion rejects the adoption of Mareva type injunctions for the United States by the Federal Courts.

The *Grupo Mexicano* case did not decide legal issues specifically relating to fraudulent conveyances. The Court did find that the transfer of property by a debtor to avoid creditors in pursuing their own interest is not only entirely “proper” but is also “entirely predictable”. This merely recognized established general rules of law. For example, in *Bayview Estates Corporation, et al. v. J. Julien* (Supreme Court of Florida 114 FLA.635; 154 SO. 8/94 (1934)), which noted, “the mere fact that a person may be indebted to another does not render a conveyance of his property a fraud in law upon his creditors. The owner of property, whether real or personal, possess the absolute right to dispose of all or any part of it as he sees fit.” The restriction noted by the court dealt with an existing right in a creditor. Thus, the court determined, “To constitute a fraudulent conveyance there must be a creditor to be defrauded, a debtor intending fraud, and a conveyance of property which is applicable by law to the payment of a debt due.” Under the court’s view, “Even if the creditor avails himself of the statute Sec. 5035, and brings his bill before reducing his claim to judgment, he must have first instituted his action in the proper courts at law for collection of his claim and then no decree will be entered upon the creditor’s bill until the claim shall have been reduced to judgment.” (emphasis added) This requirement of exhaustion of remedies and judgment on the debt was upheld by Justice Scalia in *Grupo Mexicano*.

The actions of fraud and fraudulent conveyance are separate causes of action, The nature of the allegations required in filing a complaint would distinguish the use of the terms “fraud” as opposed to “fraudulent conveyances,” because they are used in different legal scenarios and require different elements in their pleadings. As noted in *Donald F. Nobles et al., petitioners, v. Charles Marcus et al.*, respondents 533 S.W. 2D 9/23 (1976) the Texas Court stated that “Fraudulent conveyance requires a technical pleading that relies on specific allegations including one that alleges the transfer to have been a fraud against the rights of the creditors; *it is in addition to and separate from an action for fraud.*” (emphasis added)

The court in *re Henry Gehrman* 103 B.R. 3/26/ (BKRTCY.S.D.FLA. 1989) noted that the Uniform Fraudulent Transfer Act was remedy law and could be applied retroactively. It would appear, however, that it would be impossible to apply the Uniform Fraudulent Transfer Act or the Uniform Fraudulent Conveyance Act prospectively because one of the elements in filing the separate petition under the UFTA or UFCA as a cause of action is an allegation that a transfer of property has, in fact, taken place. Without the transfer or conveyance of property, one of the necessary elements in alleging a cause of action is not yet ripe. Importantly, for a court to have jurisdiction to maintain the action all necessary parties must be within the jurisdiction of the court. This, of necessity, would include the transferee of the property subject to the action.

Fraudulent conveyance actions frequently are included with other allegations. *Mack v. Newton* (737 F.F. 2nd 1343 (1984)) was a case in which a junior lien holder and trustee brought an action against debtors, principals, and lender seeking recovery on the basis of civil conspiracy, conversion, fraudulent conveyances, and usury. As to the civil conspiracy issue, the court noted, “The Texas Supreme Court has held that a general creditor does not have a cause of action for civil

conspiracy when a debtor's property is conveyed to others to evade payment"..... "The damage suffered by a general creditor when property is fraudulently conveyed to another to evade payment is the deprivation of an opportunity to make a levy on the property."⁹²

As to the fraudulent conveyance issues, the court in *Mack* stated that "however, the general rule under the Bankruptcy Act is that one who did not actually receive any of the property fraudulently transferred (or any part of a "preference") will not be liable for its value even though he may have participated or conspired in the making of the fraudulent transfer (or preference)".... "Recovery may be had only against persons who have received the property in question." The court goes on to observe that "the purposes of those sections of the Bankruptcy Act which are here relevant is clearly to preserve the assets of the bankrupt; they are not intended to render civilly liable all persons who may have contributed, in some way, to the dissipation of those assets. The Act carefully speaks of conveyances of property as being 'null and void', and authorizes a suit by the trustee to reclaim and recover such property or collectives value. The actions legislated against are not 'prohibited', those persons whose actions are rendered 'null and void' are not made 'liable', and the term such as 'damages' are not used. The legislative theory is cancellation not the creation of the liability for the consequences of a wrongful act." (emphasis added)

The court went on in analyzing the Texas Fraudulent Conveyance Statute by stating, "We are persuaded that the Texas Statute, like the Bankruptcy Act, does not provide for recovery other than recovery of the property transferred or its value from one who is directly or indirectly a transferee or recipient thereof. The Texas Statute does not purport to do anything other than render the transfer 'void' with respect to designated persons. It operates against the title of an 'innocent' transferee who has not paid value just as fully as against the title of a transferee who has participated in a fraud. It does not purport to vary its operation on the basis of participation in wrongdoing or lack thereof. Nowhere does it purport to prohibit any transfers or to render the making or receiving of them illegal or wrongful. The statute contains no words such as 'damages' or 'liability' or 'actionable'. (emphasis added) This is simply a recognition that the theory of fraudulent conveyance law is the recession of a transfer not the creation of liability.

Determining liability and whether assisting a debtor in transferring assets would be wrongful or unlawful was decided in the *Federal Deposit Insurance Corporation v. Porco* 552 N.Y.S. 2nd 910 (CT. APP. 1990), where the Federal Deposit Insurance Corporation sought recovery for funds which were transferred by officials of a bank to an account in Switzerland. The plaintiff conceded the point that the traditional rule in the State of New York rejected any cause of action for mere participation in the transfer of a debtor's property prior to the creditor obtaining a judgment or a lien on the property. However, the plaintiff argued that the rule was changed due to the Debtor and Creditor Law which is the State of New York form of the Uniform Fraudulent Transfer Act. The court noted that "These sections did not either explicitly or implicitly create a creditor's remedy for money damages against parties who, were neither transferees of the assets nor beneficiaries of the conveyance." The Court determined that "Nor is there merit to the plaintiff's argument that Section 273-A of the Debtor and Creditor law [which contains the Fraudulent Conveyance Law provisions] created a creditor's cause of action in conspiracy assertable against non-transferees or non-beneficiaries solely for assisting in the conveyance of a debtor's assets. Rather that section simply defines a fraudulent conveyance as one made without fair consideration by a debtor who is defending an action for money damages or against whom a judgment has been rendered where the

debtor ultimately fails to satisfy the judgment.”

Similarly, in *Federal Deposit Insurance Corporation v. The S. Prawer and Co.* 829 F. Supp. 453 (U.S. Dist. Ct. 1993) the court reviewed the implications of the Uniform Fraudulent Transfer Act by a debtor and purchase of debtor’s assets. The court found that “The Maine Uniform Fraudulent Transfers Act (citation omitted) permits a ‘creditor’ to avoid a fraudulent transfer, to attach an asset fraudulent transferred, or to invoke other equitable remedies including injunctions, appointment or receivers or damages. The Maine Act is derived in major part from the earlier Uniform Fraudulent Conveyance Act which had not been enacted in Maine. Other courts have persuasively concluded that actions to set aside fraudulent conveyances under the Uniform Fraudulent Conveyance Act are in the nature of contract rather than tort actions.” (emphasis added) The court, in looking at a New York case because the New York Debtor and Creditor Law adopted verbatim the Uniform Fraudulent Transfer Act, noted that the New York Court of Appeals “When faced with a complaint very similar to that before us in the instance case, held that the gravamen of the complaint was an action in equity to set aside the fraudulent conveyance. The fact that the complaint alleged actual intent on the part of the debtor to evade the creditor, did not transform the complaint into an action to recover on the ground of actual fraud.” (emphasis added) The court, further stated “... The fraud, such as it is, is only incidental to the right of the creditor to follow the assets of the debtor and obtain satisfaction of the debt. The gravamen of the cause of action in the case at bar is the ordinary right of a creditor to receive payment; this right has been implemented by the protection of legislation concerning the circumstances under which the creditor may avail himself of assets which the debtor has transferred to others.”

The *S. Prawer* court observed that many other courts have adopted this reasoning; in circumstances where a fraudulent conveyance claim was not a tort claim for purposes of the Federal Tort Claims Act; finding a fraudulent conveyance claim and not to be a tort for purposes of choosing the appropriate statute of limitations. Specifically, the court states, “The court is satisfied that the fraudulent conveyance claim alleged in this complaint is not a tort. Therefore, civil conspiracy to commit a fraudulent transfer cannot stand as an independent basis of civil liability”. The court went on to review a claim by the FDIC as to an action for aiding and abetting and found that aiding and abetting liability did not exist under the common law, but was entirely a creature of statute.”

As to these issues of aiding and abetting and conspiracy, the court in *Cenco, Inc., v. Seidman* 686 F. 2d 4 49th (1982) stated, “There is no tort of aiding and abetting under Illinois Law or, so far as we know, the law of any other state; all the cases that Cenco has cited with regard to this count are criminal cases. This is not a gap in tort law.” The court then stated, “We have much the same reaction to the conspiracy count though the fact that Seidman does not argue that there is no tort of conspiracy makes us diffident about disposing of it on this ground. Tort law, unlike criminal law, does not punish ‘inchoate’ which is to say purely preparatory conduct; for wrong doing to be actionable as a tort there must be an injury... there is no basis in common law thinking for a tort of conspiracy to commit a tort.”

These principles of law were highlighted in *Bernstein v. Portland Savings and Loan Association* 850 S.W. 2d 6 1994 (Court of Appeals of Texas 1993) where an action was brought against an attorney by a savings and loan alleging fraud, conversion, and civil conspiracy arising out of a transaction. The jury was instructed on three different types of fraudulent acts that were made

points of error on appeal. These dealt with a failure to disclose information with intent to induce action, material misrepresentation, and failure to correct a statement that was actually false. The court accepted all three points of error. It found that as to the silence, “A duty to disclose can arise when the parties have a fiduciary or confidential relationship... The testimony shows that Bernstein’s only contact with Portland occurred in the contact of these negotiations. Such limited arms length contact is not the stuff of which fiduciary or confidential relationships are made.” The court also noted that silence does not create in a lawyer a duty to disclose confidential information to third parties about his client. [Attorneys are barred under the ethical rules from knowingly revealing confidential information unless an act by a client is likely to result in death or substantial bodily harm to a person]. As to the issue of material misrepresentation, the court determined that a lawyer could be held for misrepresentation “When the speaker made the representation he knew it was false and made it recklessly without any knowledge of its truth as a positive assertion.” That is not a fraudulent conveyance but is an actual fraud involving misrepresentation with the inducement for detrimental reliance. As to the failure to update, the court determined that there is no duty to update.

As regards the claim of conversion the court found that as to the attorney there was no evidence that he had any time personally exercised dominion or control over any of the plaintiff’s assets. This is applicable even if the attorney prepared the agreements which enabled the client to take possession of the assets. As to the conspiracy claim, the court determined that mere knowledge and silence are not enough to prove conspiracy. Because there is an attorney’s duty to preserve client confidences, there must be an indication that the attorney agreed to the fraud.

The term “fraud” is being used under the common law of deceit and not in reference to a remedy under a fraudulent conveyance statute. This is in keeping with evidence of an attorney’s knowledge of the fraudulent nature of his and other’s actions and intent to share in the fruits of that fraud. In this case the evidence showing the attorney’s involvement in preparing the safe keeping agreements was insufficient to show his involvement in a conspiracy to defraud.

In the case of the Committee of Unsecured Creditors of Interstate Cigar Co., Inc. v. Interstate Distribution, Inc. (620 N.Y.S. 2d 78,79) (Supreme Court Appellate Division 1994) the court reviewed an action against shareholders and officers of the debtor transferor for damages for conspiracy for tortious inducement to violate the Bulk Sales Law. As noted by other courts, the Bulk Sales Law is a special form of a fraudulent conveyance act. The court noted that “The statute does not create a cause of action to recover damages for conspiracy or tortious inducement to violate the Bulk Sales Law. “... A creditor’s remedy is to sue in equity to set aside the conveyance. The creditor may not seek a personal judgment in tort or otherwise against the transferor or the transferee for noncompliance with the Bulk Sales Law.”

The court stated, “Viewing the allegations asserted in the complaint in the light most favorable to the plaintiff, the court properly dismissed the second cause of action insofar as it asserted against the appellants – respondents. When a conveyance is fraudulent as to a creditor, that creditor may have the conveyance set aside or disregard the conveyance and attach or levy execution upon the property conveyed. These sections of the Debtor and Creditor law did not, either explicitly or implicitly, create a creditors remedy for money damages against parties who were neither transferees of the assets nor beneficiaries of the conveyance.” The court goes on also to note; “There is nothing improper about preferring certain creditors over the plaintiff.” The same point of law was

stated by Justice Scalia in *Grupo Mexicano*. Under the adversarial system of law each side may fully utilize their respective legal rights.

CONCLUSION

The term “fraud” is distinct from the term “fraudulent conveyance.” As applicable under the ethical rules, the term fraud is defined under the law of deceit as applicable to the conduct of a lawyer to a third party. The term “deceit” refers to actual fraud.⁹³ It does not include, for ethical rule purposes, a “fraudulent conveyance” or “fraudulent transfer.” Those terms are defined under specified remedy statutes. They are not defined under the common law of deceit.

As to the clients’ conduct, the conveyance of property which may later be subject to an action under the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act or a similar statute is not unlawful nor is it tortious. A creditor has no cognizable interest in the property of a debtor prior to judgement. The transfer of freely alienable property by a debtor to avoid a creditor is “entirely proper” and “entirely predictable” as specifically enunciated in *Grupo Mexicano*. The attorney providing related legal services has no ethical duty to a third party non-client when providing those services to his or her client. There is no common law tort of aiding and abetting. There is no common law tort of conspiracy. There is no common law tort of fraudulent conveyance. These are unknown under the tort law of the United States.

The term “fraud” for purposes of Model Rule 1.2(d) and 8.4(c) does not include conduct under the statutory remedy commonly known as fraudulent conveyance or transfer law. Perhaps the ethical resolution of these issues has been best summed up by Professor Wolfram:

“To this point, the focus has been upon client conduct that is criminal, fraudulent or contrary to a direct rule of a court. Are the considerations different if the clients’ conduct is not of this description but violates other law? For example, what if the client wishes to pursue a course of conduct which is unconscionable under applicable law but is not criminal, fraudulent or in violation of a court order? What if client conduct violates the law of torts, contracts, property or some other noncriminal law that does not deal with fraud? Under the Model Rules a lawyer who assists the conduct described definitely commits no professional offense.”⁹⁴

¹ The Author gratefully acknowledges the assistance of Daniel Fox in the research and Bart Udell for the discussions which are the basis on which this paper was prepared.

² ABA 1983 Model Rules of Conduct Preamble.

³ Modern Legal Ethics, Charles W. Wolfram, § 1.6 p. 17

⁴ Rule 1.7(b)

⁵ As noted in the Preamble to American Lawyers Code of Conduct (Copyright 1982 by Roscoe Pound

Foundation) “Recognizing that the American attorney functions in an adversary system, and that such a system expresses fundamental American values, helps us to appreciate the emptiness of some cliches of lawyers ethics In the context of the adversary system, it is clear that the lawyer for a private party is and should be an officer of a court as a zealous, partisan advocate of one side of the case before it and in the sense of having been licensed by a court to play that very role.

⁶ Terminology (4)

⁷ Memo from Frederick C. Stimmel, Counsel New York Bar Association, see note: Client Fraud and The Lawyer. An Ethical Analysis, Minnesota Law Review Vol. 62.89, Footnote 71.

⁸ Professor Prosser criticized the “indiscriminate use of the word “fraud”, and a work so vague that it requires definition in nearly every case.” The essential elements of common law fraud are: (1) a false representation of fact, (2) Knowledge or belief that the representation is false, (3) an intention to induce another to act or refrain from action in reliance on the representation, (4) justifiable reliance by such person and (5) damage resulting from such reliance. W. Prosser, Torts § 105, at 684-685 (4th ed. 1971).

⁹ Uniform Fraudulent Transfer Act 1984 ("UFTA") & progeny

¹⁰ 37 Am. Jur.. 2d, Fraud and Deceit §232

¹¹ Peter A. Alces, Cardozo Law Review 1987, vol.9, No. 2, Dec. 743 at 754.

¹² Haines v. Giambrone, 471 N.E. 2d 801, 808 (Ohio APP..1984)

¹³ See supra note at §§1,2

¹⁴ Lively v. Garnick, 287 F.2d 553,555 (Ga. App. 1981) certiorari den'd February 10, 1982, citing Dundee Land Co. v. Simmons, 204 Ga. 248, 249, 149 So. 2d 488 (1949) (“Fraud, unlike negligence, breach of warranty or breach of contract, is premised upon the 'actual moral guilt' of the defrauding party.”).

¹⁵ See e.g. Ga. Code Ann. §§ 105-302; Stonemets V. Head, 154 S.W. 108, 114 (Mo. 1913); Haines v. Giambrone, supra note 4 at 808; First Union Brokerage Services v. Milos, 744 F.Supp. 1145, 1155 (S. Dist. Fla. 1990); and Taylor v. Kenco Chemical and Mfg. Corp., 465 S.2d 581, 589 (1st DCA 1985).

¹⁶ Gommillion v Forsythe, 218 S.C. 211, 62 S.E. 2d 297

¹⁷ See supra, note 3, §14

¹⁸ Blacks Law Dictionary, Abridged Ed.1983

¹⁹ See supra, note 11 at 754.

²⁰ Id.

²¹ See supra note 11 at 754, footnote 58

²² See e.g. Steigman V. Danese 502 S. 2d 463,468 (Fla. 1st DCA 1987) Three elements: 1)a representation by the defendant designed to prompt action by the plaintiff, 2) falsity of the representation and the defendant's knowledge of the falsity, and 3) the plaintiff's reliance on the representation to his detriment; First Union Brokerage Services V. Milos see supra note 7 at 1155, Four elements: 1) a false statement concerning a material fact, 2) knowledge by the

maker of the statement that the representation is false, 3) intent by the maker of the statement that the representation will induce another to act on it, and 4) justifiable reliance on the representation to another's detriment; Taylor V. Kenco Chemical and Mfg., see supra note 7 at 589, also four elements; Echols v Beauty Built Homes, Inc. 647 P.2d 629, 631 (Ariz. 1982), citing Nielson V. Flashberg, 101 Ariz. 335, 419 P.2d 514 (1966). A showing of fraud requires nine elements: 1) a representation, 2) its falsity, 3) its materiality, 4) the speaker's knowledge of its falsity or ignorance of its truth, 5) the speaker's intent that it be acted upon by the recipient in the manner reasonably contemplated, 6) the hearer's ignorance of its falsity, 7) the hearer's reliance on its truth, 8) the right to rely on it, 9) his consequent and proximate injury.

²³ See e.g. *Id* at 631, quoting *In re McDonnell's Estate*, 65 Ariz. 248, 253, 179 P.2d 1064 (1975).

²⁴ See Stonemets v. Head, supra note 15, at 114. "Fraud being infinite and taking on protean form at will, were courts to cramp themselves by defining it with a hard and fast definition, their jurisdiction would be cunningly circumvented at once by new schemes beyond the definition. Messieurs, the fraud-feasors, would like nothing half so well as for courts to say they would go thus far, and no further in its pursuit."

²⁵ W. Prosser, *Torts* § 105, at 684 (4th ed. 1971). Prosser enumerates the following essential elements of common law fraud: 1) a false representation of fact; 2) knowledge or belief that the representation is false; 3) an intention to induce another to act or refrain for action in reliance on the representation; 4) justifiable reliance by such person; and 5) damage resulting from such reliance.

²⁶ *Id.* At 685-685.

²⁷ See, e.g. Ala. Code §§ 6-5-100 to 104 (1975); Cal. Civ. Code Ann. §§ 1571-2574 (1962); Ga. Code Ann. §§ 51-6-1 to 4 (1981); N.D. Cent. Code §§ 9-03-07 to 10 (1975); S.D. Codified Laws Ann. § 20-10-2 (1987)

²⁸ See, supra note 3, § 8 citing, e.g. Jackson v State, 210 app. Div. 115, 205 NYS 658, aff'd. 241 NY 563, 150 NE 556.

²⁹ See 17 Am. Jur. 2d, *Contracts* § 18 citing Sprinkle v Wellborn, 140 NC 163, 52 SE 666 ("The first essential element of a contract is consent, and there can be no true agreement without the capacity to understand it, and freedom to accept or reject the thing proposed).

³⁰ *Id.* §8.

³¹ See supra note 3, § 8, citing Commissioner of Banks V Cosmopolitan Trust Co. 253 Mass 205, 148 NE 609, 41 ALR 658; Ettlinger v National Surety Co. 221 NY 467, 117 NE 945, 3 ALR 865; Telford v Metropolitan L. Ins. Co. 223 App. Div. 1775, 228 NYS 54, aff'd 250 NY 528, 166 NE 311 ("But where the deception induced by misrepresentation relates to the nature of the contract which another is thereby induced to execute, and produces such essential error that the person so tricked and deceived may be said never to have intended to make any contract of the nature alleged, the so-called contract is deemed wholly void ab initio")

³² Brown v Scott, 140 Md. 258, 117 A. 114, 22 ALR 810; see also 17 Am. Jur. 2d, *contracts* §§151, 152 concerning the effect of fraud upon the formation of contracts.

³³ See 25 Am. Jur. 2d, *Duress and Undue Influence* §§1, 35, 36.

³⁴ *Id.*

³⁵ See supra, note 3, §327

³⁶ *Id.* §§327, 336.

³⁷ Id. §327.

³⁸ Id. §328; 25 Am. Jur. 2d Election of Remedies §27 see e.g. *Hanes v Giambrone*, supra note 4, at 808 (“Fraud subjects a party to a liability for damages for the wrong, or it may vitiate the contract and enable the injured party to recover money paid upon it”).

³⁹ See e.g. *Hansman v Oneida County*, 366 N.W. 2d 901 (Wis. app. 1985) (Under the "benefit of the bargain rule" the measure of damages is the difference between the value of the property as it was when purchased and what it would have been had it been as represented) (Proximately caused consequential damages, if proved with reasonable certainty and not duplicative of general damages, may be recovered in cases of negligent misrepresentation), see infra discussion of "constructive fraud."

⁴⁰ See e.g. *Echols v. Beauty Built Homes, Inc.*, supra note 14, at 632.

⁴¹ See e.g. *Hanes v Giambrone*, supra note 13, at 808.

⁴² Id. See also *Steigman v Danese*, supra note 22, at 466 citing Thomas for *Fennell v Lampkin*, 470 So. 2d 37, 39 f.n. 2 (Fla. 5th DCA 1985) ("The term 'confidential relationship' encompasses 'virtually all relationships of trust and dependence,'"")

⁴³ *Taylor v. Kenco Chemical and Mfg.*, see supra note 15 at 589; See e.g. *Hanes v Giambrone*, supra note 12, at 808 (“‘Constructive’ fraud often exists where the parties to a contract have special confidential or fiduciary relation which affords the power and means to one to take undue advantage of or exercise undue influence over another).

⁴⁴ *First Union Discount Brokerage Services v. Milos*, see supra note 15 at 1155

⁴⁵ *Taylor v. Kenco Chemical and Mfg.*, see supra note 15 at 1155

⁴⁶ Id.

⁴⁷ See e.g. *Hanes v Giambrone*, supra note 15, at 808-809

⁴⁸ See *Hansman v Oneida County*, supra, note 39 at 899-901.

⁴⁹ See e.g. *Moldofsky v. Stregack*, 449 So. 2d 918, 919 (Fla. 3rd DCA 1984); *Ramel v. Chasebrook Construction Company*, 135 So. 2d 876, 882 (Fla. 2d DCA 1961);.

⁵⁰ See e.g. *Lively v. Garnick*, supra, note 14 at 555.

⁵¹ See e.g. *Ramel v. Chasebrook Construction Co.*, supra, note 49 at 882.

⁵² Id.

⁵³ *Moldofsky v. Stregack*, see supra, note 49 at 919, 920.

⁵⁴ See e.g. *Ramel v. Chasebrook Construction Company.*, supra, note 41 at 882.

⁵⁵ 50 Edw. III (1376) ch. 6. Set out in Am Jur 2d Desk Book Document No. 106.

⁵⁶ Id.

⁵⁷ St 27 Eliz I (1585) ch 4 set out in Am Jur 2d Desk Book Item No. 208, which extended protection to subsequent bona fide purchasers.

⁵⁸ St 13 Eliz I (1570) ch 5 set out in Am Jur 2d Desk Book Item No. 207. The enactments against fraudulent transfers were, presumably, declaratory of existing principles of the common law. 37 Am Jur 2d §2.

⁵⁹ 37 Am Jur 2d §10.

⁶⁰ 37 Am Jur 2d §§2, 3; Rod Anderson, *Creditors' and Debtors' Practice in Florida*, January 1994, §7.2; Uniform Fraudulent Conveyance Act 1918 ("UFCA"); Uniform Fraudulent Transfer Act 1984("UFTA").

⁶¹ 11 USC §544, 548.

⁶² *Fraudulent Conveyance Law: Modern Uses and Abuses*, Practising Law Institute, 1991, at 197.

⁶³ Title XXVII – Banking Law Enforcement, Federal Deposit Insurance Act, 12 U.S.C. 1821 (d).

⁶⁴ Title XXVII – Banking Law Enforcement, Federal Credit Union Act (12 U.S.C. 1787 (b)).

⁶⁵ *In Re Warner*, 87 B.R. 199, 202 (Bkrtcy. M.D. Fla. 1988) Transfers may be voided under §§544, 548 of the Bankruptcy Code if the debtor's actual intent to hinder, delay, or defraud his creditors is found.

⁶⁶ *United States V. Ressler* 433 F.Supp. 459, 464 (U.S. Dist. Ct. S.D. Fla. 1977). See also *In Re Gefen* 35 BR. 368, 372 (Bkrtcy. 1984) (Debtor, one month after judgment was entered against him, four days after he was subpoenaed for his deposition in aid of execution and one week before his scheduled deposition in aid of execution, transferred \$28,000.00 from his I.R.A. accounts into a deferred annuity. The debtor was clearly aware of pending litigation at time of transfer, and the transfer had the "legal effect" of hindering, delaying or defrauding creditors) but contrast with *Jacksonville Bulls Football v. Blatt* 535 So.2d 626, 629 (Fla. 3rd DCA 1988) ("[M]ere fact that suit is pending against a person, or that a person is indebted to another, does not in and of itself render fraudulent that person's conveyance of property," where debtor received reasonable consideration for the transfer and used cash to satisfy other creditors)

⁶⁷ See UFTA §4(a)(2); 11 USC §548. Insolvency itself is broadly defined. The debtor is considered insolvent if he was engaged or about to engage in a business or transaction, or intended to incur or should have known he would incur debts beyond his ability to pay them as they became due. He is insolvent if the sum of debts exceeds the fair market value of assets. Insolvency is presumed if the debtor is not paying his debts as they become due. UFTA §2(b).

⁶⁸ See *supra* note 60; UFTA §4(b), Consideration may be given, among other factors, to whether: 1) the transfer was made to an insider; 2) the debtor retained possession or control of the property transferred; 3) the transfer was or concealed; 4) before the transfer was made, the debtor had been sued or threatened with suit; 5) the transfer comprised substantially all 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 not reasonably equivalent to the value of the asset transferred; 9) the debtor was insolvent or became insolvent shortly after the transfer was made; 10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and 11) the debtor transferred the essential assets of his business to a lienor who transferred the assets to an insider of the debtor; and *In Re Warner* *supra* note 65.

⁶⁹ See Anderson, *supra* note 60, §7.7

⁷⁰ *Id.*

⁷¹ See e.g. *Hamilton Michelson Groves Company. v. Penney* 58 F2d. 761, 763 (Fla. 5th DCA 1932).

⁷² See for example, respectively Florida Statutes Annotated §§726.108 (1)(a), 726.108(1)(b), 726.108(1)(c)1, 726.108(1)(c)2, 726.109(2)-(3), 726.109(1)(c)3.

⁷³ 11 USC §548(a) – (b); see e.g. In Re Gherman, 103 B.R. 326, 331 (Bkrctcy. S.D. Fla. 1989).

⁷⁴ Ibid. 11 USC.

⁷⁵ 11 USC §§544(b)l 502

⁷⁶ Often UFTA or UFCA as adopted by the State. See e.g. *Havee v. Belk* 775 F.2d 1209 (CA4 NC 1985); In Re Bygraph, Inc. 56 BR 596 (Bkrctcy. S.D. NY 1986); Re Eidson 10 BR 432 (Bkrctcy. N.D.GA 1981). See also In Re Gherman, supra note 58 at 331 ("I conclude that the present Florida Uniform Act is remedial and should, therefore, be applied retroactively")

⁷⁷ See e.g.. Florida Statutes §726.110(1) (An action based on actual fraud must be brought within four years after transfer or, within one year after the transfer was or reasonably could have been discovered); §726.110(2) (An action based on constructive fraud must be brought within four years after transfer regardless of when the fraud was or could have been discovered; §726.110(3) (An action to avoid an impermissible preference to an insider must be brought within one year after transfer)

⁷⁸ Title XXXIII – Federal Debt Collection Act (Six year statute of limitations).

⁷⁹ See e.g. *Taylor v. Kenco Chemical & MFG. Corp.* 465 So.2d 581, 589 (Fla. 1st DCA 1985) (In order to recover punitive damages in a suit on a contract, the tort action must arise out of conduct independent of that constituting breach of contract).

⁸⁰ 18 USCA§§2, 152.

⁸¹ See Glenn W. Merrick, Representing the Debtor: Counsel Beware! The Colorado Lawyer, March 1994, vol. 23, No. 3 at 542. See also U.S.C. §§ 152.371; United States v. Edgar, 971 F. 2d 89 (8th Cir. 1992); United States v. Brown, 943 F.2d 1246 (10th Cir. 1991); United States v. Zimmerman, 943 F.2d 1204 (10th Cir. 1991); 12 C.F.R. §§21.11,563.180(d), 18 C.F.R. §586(a) (3) (F); 11 U.S.C. §§503(b) (4); 18 U.S.C. §§6001-6003.

⁸² See Paul W. Raymond, Attorney Liability: Is Popkin and Aberration or a Hint of Things to Come? Journal of Asset Protection, Nov./Dec. 1996 analyzing *Unites States v. Popkin*, 943 F2d 1535 (1991).

⁸³ Id.

⁸⁴ Cal. Penal Cod §531 (West 1988); III. Compiled Ann. Stat. Ch. 720 §260/122 (West's Smith-Hurd 1991). See also Model Penal Code §§224.10, 224.11, 10 ULA 433.563 (1962; Tex. Penal Code Ann. §§32.33, 32.34 (Vernon 1989); Pa. Stat. Ann. Tit. 18§§4110,4111 (Purdon 1983); NY Penal Law §§185.00-185.15 (McKinney 1988).

⁸⁵ See the discussion in Section 4 of this paper.

⁸⁶ ABA Model Rules of Professional Conduct Rule 1.2(d) (1997) 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 consequence of any proposed course or conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

⁸⁷ See e.g. *In Re Pfingst*, 53 AD2d 268, 385 NYW2d 806 (1976) (Attorney convicted of fraudulent transfer and concealment in contemplation of bankruptcy, subsequently disbarred); *Kline v. Ushkow*, 34 AD2d 159, 310 NYS2d 378 (1970) (Attorney engage in fraudulent transfers and gave false testimony suspended from practice of law).

⁸⁸ *Coppock v. State Bar of Cal.* 44 Cal. 3d 665, 244 Cal. Rptr. 462 P2d 1317 (1988) (Attorney disciplined for allowing client to use attorney's trust account to hide assets from judgement creditors, and was required to make restitution even though he did not know about or benefit from the fraud). Is an attorney acting in the role of a trustee of monies in a trust account providing legal services? Apparently not.

⁸⁹ Cited as authority in *Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 2000 N.Y. slip Op. 03310 (March 30, 2000) where a debtor engaged in asset stripping to avoid satisfying a judgement awarded to plaintiffs.

⁹⁰ An applicable comment was made regarding offshore asset protection trusts in a paper entitled Asset Protection and the Statute of Elizabeth by Anthony Travers, M.A. (Cantab). P.15. "I should perhaps say a final word about the bright line because there is no doubt that the New Law [referring to the new Cayman Islands asset protection trust law] will be controversial. On this point, I think it is helpful to consider the thinking of the 19th Century judges when they laid down their various dicta in the nineteenth century. Limited liability companies were then still in their infancy and the concept of a man walking a limited liability company until the leading company law case of *Salamon v. Salamon* when it wen to the House of Lords in the United Kingdom in 1897. That being the case, ask this question. If Mr. Butterworth the baker had formed a limited liability company in which to undertake his grocer's business or his baker's business he would have been able to walk away unscathed from the debts of these businesses. If a man may avoid liabilities to future creditors by the establishment of a limited liability company there seems no establishment of a Cayman Islands trust."

⁹¹ On this basis such widely cited cases as *Dalton v. Meister*, 239 N.W. 2d 9 (Sup. Ct. of Wis., 1976) are no longer valid. There the Court stated, without citation to statute or case decision, that "Here there is no question that fraudulent conveyances of Meister's property, if proved, would be unlawful." (page 18) This then led to the finding of civil conspiracy. Under the Supreme Court decision in *Grupo Mexicano* this is clearly an incorrect statement of law and is invalid. Cases which have relied on *Dalton v. Meister* such as *McElhanon v. Hing* (728 P. 2nd 256 Arizona 1985) must look to other law for support since under *Grupo Mexicano* a debtor's transfer of his or her property, even if to avoid a creditor, is "entirely proper and entirely predictable". See *Grupo Mexicano De Desarrollo, S.A., et al v. Alliance Bonde Fund, Inc., et al* (No 98-231 decided June 17, 1999). A creditor, however, can then use whatever legal rights are then available under fraudulent conveyance law or bankruptcy law. Two important and usually overlooked points of *McElhanon v. Hing* are, first, that the court stated that "McElhanon concedes that the fraudulent conveyance, without more, created no liability" (p. 262). However, Hing acted beyond the scope of being a mere lawyer. He became a participant by taking the stock and then abusing the legal process with the result of enabling the company to be made worthless. Abuse of process or malicious prosecution are recognized torts and can be the basis for a claim of unethical behavior. Second, the court in finding a valid claim for damages arising from conspiracy determined that the second of four elements proving the cause of action requires that the party against whom damages are claimed must be guilty of actual fraud as opposed to constructive fraud. In *McElhanon*, it need be remembered, that Hing was ultimately the transferee of the stock that was the subject of the litigation.

⁹² This is also keeping with *Miramar Holding Corp., v. Day* 362 SO. 2d 305 (District Court of Appeal of Florida 3rd District) (1978), where an action was brought against an attorney who was impleaded as a third party. The Court noted, "The learned judge was correct in vacating the money judgment against the impleaded third parties [the attorney]... As the above impleaded third parties possess none of the assets of the judgment debtor." This follows the underlying legal principle that fraudulent conveyance law is founded as a remedy allowing for the rescission of a transaction and not the creation of liability for damages.

⁹³ 37 Am Jur 2d, Fraud and Deceit §1.

⁹⁴ Modern Legal Ethics, Charles W. Wolfram, (West Publishing, 1986) p. 704, §13.3.9