

ASSET PROTECTION: Ethical Considerations in Advising Clients

Peter J. Haley
Nelson Mullins Riley & Scarborough LLP

I. Introduction

"Asset Protection" is an area of the practice, which more than any other, raises ethical concerns for lawyers. Many ethical issues present themselves in an intuitive fashion; "this just doesn't seem right" is a familiar, if unwelcome, thought to many when first hearing the plans or ambitions of a prospectively insolvent client. In evaluating those issues beyond the first gut reaction it is helpful to approach the issues by reviewing the applicable rules, code and laws which govern our conduct as lawyers in a systematic fashion. This review will help concentrate both the lawyer and the client on pursuing a course of action which is consistent both with the lawyer's professional obligations and, ultimately, the best interests of the client.

A. A Lawyer Is Not a Bus

Unlike the local municipal bus faced with waiting riders at the bus stop, you do not need to stop and pick up every client. This is perhaps the best, and maybe the hardest, lesson to learn. It is frequently something that occurs to you only after you are already enmeshed in a difficult situation. In addition to the legal issues discussed below, when faced with ethical issues, take time to review them with someone else in the office or another lawyer outside your office who you trust and can rely upon for good judgment. Talking things through with another lawyer will force you to confront and explain the things which trouble you and provide a view as to how the facts appear to an outside observer.

II. Rules of Professional Conduct

Rule 1.2 -- Scope of Representation

(d) 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 consequences of any proposed course of 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.

Asset protection techniques which simply create a cause of action for a third party to pursue, a trustee or a creditor, are a poor practice. A lawyer should take the time to explain the causes of action which are available to creditors and set those forth in detail for a client.

Rule 1.16 -- Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the rules of professional conduct or other law .

It is never too late to stop representing a client and you should do so when the client engages in behavior which violates the law.

Rule 3.3 -- Candor Toward the Tribunal

"(a) A lawyer shall not knowingly:

(1) make a false statement of material fact or law to a tribunal;

(2) fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client, except as provided in Rule 3.3(e);...

(4) offer evidence that the lawyer knows to be false, except as provided in Rule 3.3(e). If a lawyer has offered, or the lawyer's client or witnesses testifying on behalf of the client have given, material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures.

(b) The duties stated in paragraph (a) continue to the conclusion of the proceeding, including all appeals, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6

III. Bankruptcy RulesA. Rule 9011

Sanctions may be imposed pursuant to Rule 9011 for both filing pleadings and later advocating positions taken that are without evidentiary support. In re Evergreen Sec., Ltd., 384 B.R. 882, 931 (Bankr. M.D. Fla. 2008) citing Turner v. Sungard Bus. Sys., Inc., 91 F.3d 1418, 1421 (11th Cir.1996).

The importunities of a desperate client do not relieve an attorney of the affirmative duty of reasonable inquiry imposed by Rule 9011. The evident warning flags and the inadequate time available to make such inquiry should have impelled [the attorney] to consider the ever-present option of declining a questionable engagement.

In re Villa Madrid, 110 B.R. 919, 924 (9th Cir. BAP 1991)

IV. Bankruptcy policy

In re Warren, 512 F.3d 1241 (10th Cir. 2008)

Some comments about bankruptcy policy are appropriate. "In determining the meaning of a statute, we look not only to the particular statutory language but to the design of the statute as a whole and to its object and policy." Grogan v. Garner, 498 U.S. 279, 288, 111 S.Ct. 654, 660 n. 13, 112 L.Ed.2d 755 (quoting *396 Crandon v. United States, 494 U.S. 152, 158, 110 S.Ct. 997, 1001, 108 L.Ed.2d 132 (1990)). "Exemptions, both under state and federal bankruptcy laws, have generally been recognized as necessary in order to preserve the debtor's access to property that is essential to 'life and livelihood,' and to shift the burden of support for the debtor and the debtor's dependents from the public to private credit sources." William Houston Brown, Political and **Ethical Considerations** of Exemption Limitations: The "Opt-Out" as Child of the First and Parent of the Second, 71 Am. Bankr.L.J. 149, 163 (Spring 1997) (herein "Brown"). One well worn but still valid phrase is that an "honest debtor" should "start afresh free from obligations." Local Loan v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 699, 78 L.Ed. 1230 (1934). The old Bankruptcy Act "gives the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." Id. (emphasis supplied). This remains equally true under the current Bankruptcy Code. Central Virginia Cmty. Coll. v. Katz, 546 U.S. 356, 363-64, 126 S.Ct. 990, 997, 163 L.Ed.2d 945 (2006) (one of the "[c]ritical features of every bankruptcy proceeding [is] ... the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts"). A countervailing principle exists--a debtor should keep only that which is legally deserved--a debtor is not entitled to a "head start." Lines v. Frederick, 400 U.S. 18, 21, 91 S.Ct. 113, 115, 27 L.Ed.2d 124 (1970) (Harlan, J., dissenting).

When discussing asset protection issues with clients, it is important to review the alternative outcomes, what is really at risk and what can be protected in the context of a bankruptcy proceeding. Frequently a client's perception of the effect of bankruptcy is skewed and does not reflect actual outcomes leading to a misplaced focus on alternative efforts.

As a caution to those who might hope to take unfair advantage of the liberality of bankruptcy discharge provisions, the transactions in which Swift engaged just before bankruptcy should be summarized. Reviewing the evidence, the bankruptcy court concluded that Swift gambled and lost on the discharge of \$2,000,000 in debt by engaging in "cute" transactions that involved approximately \$20,000 of his estate. The net effect of these transactions, however, was to dispose of or encumber his only non-exempt assets. The court also concluded that Swift would not be shielded by the fact that he consulted with numerous attorneys before engaging in these transactions.

Matter of Swift, 3 F.3d 929 (5th Cir. 1993)

V. Liability for Lawyers

A. Criminal Liability

18 U.S.C. §152 concealment of assets; false oaths and claims; bribery

18 U.S.C. §153 embezzlement against the estate

18 U.S.C. §154 improper conduct by a bankruptcy trustee or other officer of the court

18 U.S.C. §155 improper fee agreements in bankruptcy cases

18 U.S.C. §156 knowing disregard of bankruptcy law or rule by a "bankruptcy petition preparer"

18 U.S.C. §157 bankruptcy fraud

18 U.S.C. §1519 destruction, alteration, or falsification of records in a bankruptcy case

18 U.S.C. §1520 destruction of corporate audit records

18 USC § 3057 affirmative obligation on the court and the trustee in a bankruptcy proceeding to report violations of the criminal bankruptcy statutes to the U.S. Attorney. See, e.g., *In re DG Acquisition Corp.*, 208 B.R. 323 (Bankr. S.D.N.Y. 1997), *aff'd*, 213 B.R. 883 (S.D.N.Y. 1997),

aff'd, 151 F.3d 75 (2d Cir. 1998); see generally *In re El San Juan Hotel Corp.*, 239 B.R. 635 (B.A.P. 1st Cir. 1999), aff'd, 230 F.3d 1347 (1st Cir. 2000); *Collier on Bankruptcy*, ch. 7.

B. Civil Liability

In re Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C. D. Cal. 1991) (as a fiduciary of the estate, the debtor's lawyer must remind the debtor of the debtor's duties under the Bankruptcy Code).

Soderquist v. Kramer, 595 So. 2d 825 (La. Ct. App. 1992). Liability to client for allowing fraudulent conveyance to occur.

Stochastic Decisions, Inc. v. DiDomenico, 995 F.2d 1158 (2nd Cir. 1993), cert. denied, 510 U.S. 945 (1993); liability to third party creditors for assisting a client in making a fraudulent conveyance.

VI. Managing the Client Engagement

A review of the applicable rules and issues which govern the conduct of lawyers in this area is helpful not only to the practitioner, but also the client. While it may be foolhardy and naïve to assume that every potential client approaches the issues of asset protection with pure intentions, it is an equal disservice to assume the opposite. Reviewing with the client the applicable issues in a thorough and thoughtful manner will serve to establish limits of appropriate activity and help the client fashion a course of action consistent with the client's best interests and the lawyer's professional responsibility.