

Prepared for Juan Antunez

Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #235

Date: 15-Jan-14
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: [Alan Gassman & Charlie Lawrence: Imposing Punitive Damages on Fraudulent Transfers](#)

“Some states are allowing punitive damages for fraudulent transfers in bankruptcy cases, some states are not allowing punitive damages, and some haven’t decided yet. The majority of states that have considered the issue have jumped on the bandwagon to allow punitive damages for fraudulent transfers, regardless of whether the transfer is considered a crime. Only time will tell how the remaining states will fall.”

After reviewing **Jay Adkisson’s** [Asset Protection Planning Newsletter #229](#), **Alan Gassman** couldn’t help but investigate what was going on with punitive damages. He enrolled the help of **Charlie Lawrence** to investigate the situation, and their commentary captures what they found.

Alan S. Gassman, J.D., LL.M. practices law in Clearwater, Florida. Each year he publishes numerous articles in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, The Journal of Asset Protection, and Steve Leimberg’s Asset Protection Planning Newsletters. Mr. Gassman is a fellow of the American Bar Foundation, a member of the Executive Council of the Tax Section of the Florida Bar, and has been quoted on many occasions in publications such as The Wall Street Journal, Forbes Magazine, Medical Economics, Modern Healthcare, and Florida Trend magazine. He is an author, along with Kenneth Crotty and Christopher Denicolo, of the BNA Tax & Accounting book Estate Tax Planning in 2011 and 2012. He is the senior partner at **Gassman Law Associates, P.A.** in Clearwater, Florida, which he founded in 1987. His email address is agassman@gassmanpa.com

Charlie Lawrence is a 2013 **Stetson Law School** graduate and is a member of the Florida bar; she co-wrote this commentary while performing legal research for **Gassman Law Associates, P.A.**

Here is their commentary:

EXECUTIVE SUMMARY:

Some states are allowing punitive damages for fraudulent transfers in bankruptcy cases, some states are not allowing punitive damages, and some haven't decided yet. The majority of states that have considered the issue have jumped on the bandwagon to allow punitive damages for fraudulent transfers, regardless of whether the transfer is considered a crime. Only time will tell how the remaining states will fall.

FACTS:

The first punitive damages award for a fraudulent transfer that we are aware of was the Ohio case of *Locafrance United States Corp. v. Interstate Distribution Servs., Inc* that was decided in 1983. More recently, the California case of *Elie v. Smith* established that a judge may impose punitive damages on the perpetrators of a fraudulent transfer.¹ The recent Pennsylvania case of *Klein v. Weidner* also imposed punitive damages on what was found to be an “outrageous and intolerable” situation.²

The Pennsylvania statute contains the same exact language as the Florida statute, with reference to enumerating the following language as being included in the remedies that a court can impose in a fraudulent transfer action:

“1) In an action for relief against a transfer or obligation under ss. 726.101-726.112, a creditor, subject to the limitations in s. 726.109 may obtain:

(c) Subject to applicable principles of equity and in accordance with applicable rules of civil procedure:

3. Any other relief the circumstances may require.”³

In the *Klein* case, the punitive damages were imposed on the debtor, who willfully defied a court order and used unlawful and threatening means to impede the judicial process.”⁴ However, in the *Elie* case, punitive damages were imposed on both the transferee and the transferor because the debtor's behavior was “despicable and subjected Elie to cruel and unjust hardship” and that each defendant's behavior was “vile, base, and contemptible.”⁵

In the *Elie* case, a wife owing money to a third party signed an amendment to her prenuptial agreement with her spouse, which required her to transfer all of her assets to him in exchange for consideration, if any, that was not discussed in the case. To apparently attempt to make this look at arm's length, the husband sued Mrs. Smith without giving notice to the creditor. The creditor intervened in the suit and the husband and Mrs. Smith moved to Florida and filed for a Chapter 7 bankruptcy.

The California and bankruptcy courts found that the husband and Mrs. Smith engaged in clearly egregious conduct, which included, but was not limited to, what was found to be a deceptive and entirely fraudulent transfer motivated conduct, but also concealing assets with the assistance of a lawyer and severely impeded the court.

COMMENT:

The court did not comment on the lawyer's behavior, but did describe his involvement. The debtor used the lawyer's services to transfer funds and held funds in the lawyer's client-trust account.⁶ **Jay Adkisson** was not so kind. In his [Asset Protection Planning Newsletter # 229](#), Mr. Adkisson expressed his view that "there will come a time in every planner's career when a financially-distressed client will walk through the door seeking asset protection. ... It is this point in time which separates the smart planners from the foolhardy ones. The smart planners might voice sympathy for the client's plight, but will refuse to take the case... The foolhardy planners will give in to their urges, do planning where it lawfully shouldn't be done, and thereby expose their clients, their own assets, and even their careers to potentially dire consequences."

However, Mr. Adkisson does note that Florida law is different. He explains that "in some jurisdictions, such as Florida, the courts have held that an attorney cannot be liable either under a conspiracy or aiding and abetting theory for a client's fraudulent transfer." In other jurisdictions, like California and Pennsylvania, the same act is can considered a tort and, in some circumstances, a crime.

However, the lawyer in *Elie* has not seen the end of this battle. The Bankruptcy Trustee sued him on a number of claims, including unlawful and unfair business practice, injunctive relief, racketeering, negligence, fraudulent transfers, deceptive acts and practices, breach of fiduciary duty, conspiracy, accounting and constructive trust. The case against the lawyer is set for trial for July 28, 2014. In the Trustee's complaint to the court, he argued:

"The unlawful business practices of [lawyer] are likely to continue and

therefore will continue to mislead the public because [lawyer] holds himself out as a professional who renders sound legal advice yet instead he performs the above-reference unfair and unlawful activities under the guise of providing legitimate business services, which presents a continuing threat to the public.

As a direct and proximate result of [lawyer's] conduct, [lawyer] has received and will continue to receive fees for his unethical and unlawful services that rightfully belong to members of the general public who have been adversely affected by [lawyer's] conduct as well as to Plaintiff by virtue of the money and assets lost due to [lawyer's] actions.”⁷

This is much different than a situation where a client who may have a litigation or contingent liability situation goes to a lawyer and determines it appropriate to engage in conventional estate and/or business planning actions that incidentally cause insulation of assets from creditors.

Several states have found that the Uniform Act's "Remedies of Creditors" Section allows for punitive damages, including Maine, Ohio, and Utah. However, Colorado, Connecticut, and Wisconsin courts have found that punitive damages are not allowed under their respective Uniform Acts, regardless of how egregious the behavior is. All of the states relied on pre-existing state law and common law when interpreting the remedies available under the Act. See the table below for a look at where states have fallen on this issue.

What is the result of a judgment for punitive damages against the debtors besides the fact that the debtor owes more money to the creditor? If the debtor is already insolvent and has no other assets it may make no difference, but transferees will not want to have judgments against them! If the transferee receives money and can give it to the creditor, this may not be a problem, but if the transferee receives an asset of questionable value and the judge finds it more valuable than it really was, then the transferee can suffer an extreme loss, not to mention having to pay attorneys fees and punitive damages.

For example, a client with a \$500,000 IRA and a \$200,000 bank account might transfer the \$200,000 bank account into a variable annuity contract the day after a judgment is entered into by the debtor. Typically a court can award the creditor the right to set aside the transfer into a variable annuity, plus attorneys' fees and costs.

Can the judge also order that punitive damages are owed, and will this cause

loss of the IRA? In bankruptcy, punitive damages for willful and malicious injury are not dischargeable.¹¹

In re Fabian is one example of the bankruptcy court holding, and the district court affirming, that damages for willful and malicious injury are not dischargeable.¹² In *Fabian*, the debtor, through a corporation in which he was the sole officer and shareholder, entered into several agreements with a leasing broker. The agreements allowed the leasing broker to purchase equipment and software from the debtor's corporation, and then lease the same equipment and software back to the corporation. In many cases, the equipment and software did not exist or were of substantially less value than the "purchase price." As a result of the agreements, the debtor's corporation obtained about \$32 million from the leasing broker.

After he defaulted on 11 leases, the debtor transferred money to a for-profit entity that was controlled by the debtor. Also, he bought beach property, donated to a private school, and indulged in private jet travel. The debtor's corporation was forced into bankruptcy by two creditors. The bankruptcy court held, and the district court affirmed, that the transfers were fraudulent. Further, because the debtor acted intentionally, his actions met the willful and malicious injury requirement of Section 523(a)(6) of the Bankruptcy Code. The judgment regarding the willful and malicious injury caused by the debtor was not dischargeable. The table below reviews where states have fallen on this issue.

STATES	PUNITIVE DAMAGES?	AGAINST WHO?	WAS THE FRAUDULENT TRANSFER CONSIDERED A CRIME?	LAWYER CRITICIZED?
Alabama	Yes	Not Specified	Yes	No
Alaska ¹	Yes	\$12,000 against Transferor/Debtor;	Yes	No
		\$24,000 against Transferee ²		
Arizona	Yes	\$72,000 against Transferor and Transferee (same - alter ego) ²	Yes	No
Arkansas	Undecided	-	-	-
California	Yes	\$10,000,000 against Transferor and Transferee ²	Yes	Yes
Colorado	No	-	No	No
Connecticut	No	-	No	No
Delaware	Undecided	-	-	-
D.C.*	Yes	Not Specified ²	No	No

Florida	Undecided	-	-	-
Georgia	Yes	Granted against both Transferor and Transferee ²	Yes	No
Hawaii*	Yes	\$250,000 against Transferor/Debtor; Amount against Transferee Remanded ²	No	No
Idaho	Undecided	-	-	-
Illinois	Undecided	-	-	-
Indiana	Undecided	-	-	-
Iowa	Undecided	-	-	-
Kansas*	Yes	\$10,000 against Transferor/Debtor	No	No
Kentucky	Undecided	-	-	-
Louisiana	Undecided	-	-	-
Maine	Yes	\$10,000 against Transferor/Debtor	Yes	No
Maryland	Undecided	-	-	-
Massachusetts	Undecided	-	-	-
Michigan	Undecided	-	-	-
Minnesota	Undecided	-	-	-
Mississippi	Undecided	-	-	-
Missouri*	Yes	\$5,000 against Transferor and Transferee (same - alter ego) ²	No	No
Montana	Undecided	-	-	-
Nebraska	Undecided	-	-	-
Nevada	Undecided	-	-	-
New Hampshire	Undecided	-	-	-
New Jersey	Undecided	-	-	-
New Mexico	Undecided	-	-	-
New York ¹	No	-	Yes	No
North Carolina	Undecided	-	-	-
North Dakota	Undecided	-	-	-
Ohio	Yes	\$60,000 against Transferor and Transferee (same - alter ego) ²	Yes	No
Oklahoma	Undecided	-	-	-
Oregon*	Yes	Not Specified	No	No
Pennsylvania*	Yes	\$548,797 against Transferor/Debtor	No	No
Rhode Island	Undecided	-	-	-
South Carolina	Undecided	-	-	-
South Dakota	Undecided	-	-	-
Tennessee	Undecided	-	-	-

Texas*	Yes	\$500,000 against Transferor/Debtor; \$1,000,000 against Transferee ²	No	No
Utah	Yes	Not Specified	Yes	No
Vermont	Undecided	-	-	-
Virginia	Undecided	-	-	-
Washington	Undecided	-	-	-
West Virginia	Undecided	-	-	-
Wisconsin	No	-	No	No
Wyoming	No	-	No	No

*Awarded punitive damages when conduct was not a crime

¹Does not follow the Uniform Fraudulent Transfer Act.

²Transferee was found to have acted with intent to defraud.

Our original expectation was that only states that consider a fraudulent transfer to be a crime would allow punitive damages. However, this is not the case.

California has a criminal statute that caused the subject transfers to constitute clearly illegal conduct.⁸ However, Pennsylvania does not have a statute making fraudulent transfers to judgment creditors illegal and it still found punitive damages proper under the circumstances of *Klein*. Other states, including D.C., Hawaii, Kansas, Missouri, and Texas, have allowed punitive damages for fraudulent transfers when the fraudulent transfer was not considered a crime.

Conclusion

In conclusion, the majority of states that have considered the issue have jumped on the bandwagon to allow punitive damages for fraudulent transfers, regardless of whether the transfer is considered a crime. Only time will tell how the remaining states will fall.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Alan Gassman

Charlie Lawrence

TECHNICAL EDITOR: DUNCAN OSBORNE

CITE AS:

LISI Asset Protection Planning Newsletter #235 (January 15, 2014)
at <http://www.leimbergservices.com> Copyright 2014 Leimberg Information
Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person
Prohibited – Without Express Permission.

CITATIONS:

¹Elie v. Smith, 2011 WL 9349985 (Cal. Super. Oct. 13, 2011).

²Klein v. Weidner, (3d. Cir. Sept. 2, 2013).

³Fla. Stat. 726.108 (emphasis added).

⁴2013 WL 4712752 at *11.

⁵2011 WL 9349985.

⁶2011 WL 9349985.

⁷Adkisson, Jay, Asset Protection Planning Email Newsletter Archive Message 229.

¹¹11 U.S.C. §523(a)(6).

¹²In re Fabian, 475 B.R. 463 (U.S. Dist. Ct. D. Maryland 2012).; In re Fabian, 458 B.R. 235 (Bankruptcy D. Md. 2011).

⁸Cal. Penal Code §§ 154, 531a.

Copyright © 2014 Leimberg Information Services Inc.