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Trust & Estate Section

Council Notes

Vol. 29 No. 3

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IS ASSET PROTECTION BECOMING FERTILE GROUND FOR ATTORNEY LIABILITY?

By: Herb Tucker, Esq. and Alison E. Zinn, Esq.

A. Introduction.

Asset protection is one of the primary goals for most estate planning clients. These clients want to insure that the money they acquired during their lifetime passes to their intended beneficiaries, not their beneficiaries' creditors. These clients also want their attorney to insure that ex-spouses and irresponsible children cannot dissipate their estate or trust. Planning strategies, such as spend thrift trusts, discretionary trusts, qualified disclaimers, and annual gifting that serve a legitimate purpose, have been historically accepted as a safe harbor for estate planners.[1]

NOTE FROM THE EDITORS:

The Trust & Estate Section is committed to maintaining the high quality of this newsletter and will continue to publish articles on substantive legal matters, information about the activities of the Section's various committees, and substantive and procedural information provided to us from the Courts sitting in Probate. Proposed articles, comments and suggestions are always welcome and can be provided to the editors of *Council Notes*, Julia McVey at jmcvey@mcveylaw.com or Merry Balson at MBalson@bw-legal.com.

Given the current state of the economy, many clients now have creditor/debtor issues. Most estate planners recognize potential liability for knowingly assisting a client to defraud known or anticipated creditors. Unfortunately, in most instances, the estate planning process is relatively short giving the estate planning attorney very little time to get a good understanding of the client's financial situation. Typically, the client comes to the attorney's office for an initial meeting to discuss the disposition of his or her estate, the documents are then prepared, and when completed a second meeting is set up for execution. In many instances, the client may be reluctant to disclose recent financial set backs, including bankruptcies and creditors claims. In addition, it is often difficult to convince a client to complete an estate planning questionnaire disclosing their complete financial picture prior to or during the initial meeting. Time constraints and lack of candor from the client can lead to potential liability for the lawyer.

Legitimate estate planning services may later be viewed as fraudulent when the client's financial position comes into focus. Even though the attorney's role is to assist the client in estate planning and asset protection, attorneys may be liable for civil conspiracy and aiding and abetting the client's fraudulent transfers or client's breach of fiduciary duties to third parties. These types of claims may arise for the first time well after the estate plan is prepared. Why and how does this happen and what can you do to protect your client's assets and your own?

B. Attorney Aiding and Abetting Breach of Fiduciary Duty.

The Colorado Court of Appeals in *Holmes v. Young*,[2] recognized Restatement (Second) of Torts §876(b)(1977) which states, "[f]or harm resulting to a third person from the tortious conduct of another, one is subject to liability if he knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself."

In *Holmes v. Young*, the plaintiff was a limited partner in a partnership. The defendant lawyer represented the partnership in a real estate action, and the partnership settled the case. The plaintiff was dissatisfied with the settlement and obtained his own lawyer to dispute the settlement and the distribution of the settlement proceeds. Thereafter, the plaintiff settled his suit against the partnership, the general partners, and the defendants in the underlying action. In this settlement the partnership and the general partner agreed to make payments to the plaintiff. The partnership terminated at the time of this later settlement in 1983. In 1985, the defendant lawyer delivered the remaining funds of the partnership to the general partner. The defendant lawyer's involvement with the partnership ended in 1987. From 1983 until 1987, the general partner made the required payments to the plaintiff. In 1988, the general partner failed to make a payment of the plaintiff.

The plaintiff then filed an action against the partnership and the general partner, alleging breach of fiduciary duty and breach of contract, and against the defendant's lawyer for aiding and abetting a breach of fiduciary duty. The trial court dismissed the action, the

appellate court affirmed, holding that the plaintiff could not maintain a claim for aiding and abetting. Because the partnership terminated, the court found that no fiduciary duty existed between the partnership and the plaintiff or between the general partner and the plaintiff. Thus, in the absence of a fiduciary duty, the defendant lawyer could not be liable for aiding and abetting the breach of a fiduciary duty. Further, the court found that even if a fiduciary duty did exist, the defendant lawyer did not knowingly assist the breach of that duty. The knowledge required to aid and abet is knowing that the primary violator is a fiduciary and the "knowledge that the primary's conduct contravenes the fiduciary duty."

In *Alexander v. Anstine*,[3] the client followed bad advice offered by its lawyers and the company was forced to file for bankruptcy. The lawyers' advice caused the client to breach fiduciary duties owed to creditors, and the Chapter 7 trustee brought suit against both the client and lawyers for aiding and abetting that breach.

In their defense, the lawyers argued that they could not be liable to the plaintiff for aiding and abetting the client's breach of fiduciary duties because they owed no duty to the third-party creditors. The court disagreed, noting that aiding and abetting is a distinct and separate claim from legal malpractice. The tort of aiding and abetting a breach of fiduciary duty requires proof of (1) breach by a fiduciary of a duty owed to plaintiff, (2) a defendant's known participation in the breach, and (3) damages. Even in the absence of a duty owed to the plaintiff, the court upheld the jury verdict against the lawyer based on the breach of the client's fiduciary duties to its creditors.

In *Resolution Trust Corporation v. Heiserman, et al.*,[4] the Colorado Supreme Court upheld joint and several liability against defendants, including their counsel[5] to the defunct Capitol Federal Saving and Loan Assn., on various tort claims, pursuant to C.R.S. §13-21-111.5(4). Subsection (4) of C.R.S. §13-21-111.5(4) constitutes an exception to the Colorado comparative-fault rule that no defendant shall be liable for damages greater than the amount represented by the percentage of fault attributable to that defendant in causing the claimed injury or loss. Subsection (4) states: "Joint liability shall be imposed on two or more persons who consciously conspire and deliberately pursue a common plan or design to commit a tortious act. Any person held jointly liable under the subsection (4) shall have a right of contribution from his fellow defendants acting in concert."

RTC was the assignee of claims from Capitol Federal Savings, which had retained the attorney defendants as counsel and for which the other defendants served as various officers and directors. The torts for which the attorney defendants were found liable were: professional negligence, breach of fiduciary duty "and negligent misrepresentation in connection with legal services provided to . . . officers and directors in the course of establishing the asset protection trusts and partnership." The facts recited in the Court's opinion indicate that the establishment of the trusts and partnerships, "to protect [the officers' and directors'] assets from legitimate creditors, including the RTC," constituted personal legal services to those officers and directors, which facilitated the officers' and

directors' enrichment at the expense of Capitol Federal. To the Court, this conduct by the officers, directors and the attorney defendants breached all of their fiduciary duties and warranted assessment of joint and several liability, as follows: "the proper question is not whether one can conspire to be negligent, but whether when two or more persons consciously conspire and then deliberately pursue a common plan or design, the execution of such common or design results in wrongful conduct causing injury or damages. Such conduct would constitute a "tortious act" for purposes of C.R.S. §13-21-111.5(4)."

Further, the Court noted that ". . . all that is required is that there be a tacit understanding, as where two automobile drivers suddenly and without consultation decide to race their cars on the public highway. . . . It is, furthermore, essential that each particular defendant who is to be charged with responsibility shall be proceeding tortiously, which is to say with the intent requisite committing a tort, *or with negligence*."[6]

As to the requisite intent, the court elaborated "While there must be a conscious and deliberate decision to pursue a common plan or design, the actors need not have a 'specific intent' to commit a tortious act to be subject to joint liability under section 13-21-111.5(4)".[7]

In terms of third-party analysis, consider the role of the attorneys for the defendants in *RTC v. Heiserman*. They were counsel to Capitol Federal, from which the plaintiff RTC was assigned claims, and also performed *personal* legal services to the officers and directors of Capitol Federal, whom the attorneys presumably advised in their capacity as counsel to Capitol Federal. The attorneys were advising fiduciaries as to their fiduciary duties and performing legal services, including preparing trusts and partnership agreements, for those same fiduciaries in their personal capacities.

To establish a claim for civil conspiracy pursuant to C.R.S. §13-21-111.5(4), an express agreement is not necessary. However, there must be some indicia of an agreement.[8] The term "tortious act," as used in C.R.S. §13-21-111.5(4), includes any conduct other than breach of contract that constitutes a civil wrong and causes injury or damages.[9]

The estate planner's potential liability for a civil conspiracy claim and aiding and abetting breach of fiduciary duty boils down to *what the attorney knew at the time he prepared the will or trust*. Was the attorney aware his client was a fiduciary to a third party and that by effectuating the client's estate plan to protect his assets, he fostered breach of fiduciary duty? The key here is knowledge of wrongdoing. The attorney must, however, be generally aware of his role as part of an overall tortious activity at the time that he provides his services and then knowingly and substantially assist the fiduciary client with the violation.

C. Attorney Aiding and Abetting Fraudulent Transfers.

If a court equates a fraudulent transfer with fraud, the transfer can support a secondary cause of action. Courts across the country have demonstrated that civil and criminal liability can extend, not only to a debtor who defrauds his creditors, but also to the attorney who assisted in structuring the debtor's assets in a fashion that frustrates a creditor's efforts to pursue a debtor.[10]

Estate planning attorneys who knowingly assist a client/debtor in transferring assets to avoid his or her creditors may violate ethical rules. Rules of Professional Conduct forbid a lawyer to counsel or assist a client in conduct which the lawyer knows is fraudulent.[11] In addition, the Model Rules provide that an attorney may disclose information to third parties related to the representation of a client to the extent the lawyer reasonably believes necessary to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another.[12]

The increasingly popular asset protection trusts or domestic asset protection trusts can, in certain circumstances, hinder, delay, or defraud a creditor unbeknownst to the drafting attorney. While ultimately proving liability as to the attorney may be a challenge, it behooves the savvy estate planner to have a basic understanding of debtor-creditor rights and the Colorado Uniform Fraudulent Transfer Act ("CUFTA").[13]

In Colorado, the purpose of CUFTA is equitable in nature, and because its provisions are so broadly worded, the door is left wide open for creditors to more easily pursue the transferor *as well as* the estate planning attorney for claims associated with fraudulent transfers incident to estate planning services. The threshold is the underlying fraud and CUFTA provides substantial leeway to proceed toward the secondary claim of aiding and abetting against the attorney. Courts outside Colorado interpreting the Uniform Fraudulent Transfers Act ("UFTA") have imposed liability on an attorney through the "catch all" provision which allows a court to award "any other relief the circumstances may require."[14]

The CUFTA,[15] provides in part: "[a] transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (a) with actual intent to hinder, delay or defraud any creditor of the debtor."

Not only is the construction of this provision broadly worded, even the defined terms contained in the statute have wide-sweeping definitions. "Transfer" for purposes of the CUFTA means "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, disposing of or parting with an asset, or an interest in an asset and includes payment of money, release, lease and creation of lien or other encumbrance." There is no testamentary exception which would exclude changes to wills or trusts as a "transfer." If the estate planning attorney knew about the judgment against his client and knowingly

aided or abetted the fraud and still effectuated the transfer, the related creditor or beneficiary could successfully pursue claims against the client in addition to claims against the estate planning attorney.[16]

The CUFTA, specifically C.R.S. § 38-8-105(2), enumerates eleven different factors the court could consider when evaluating the intent requirement of C.R.S. § 38-8-105(1)(a). Those factors include: (1) whether the transfer or obligation was to an insider; (2) whether the debtor retained possession or control of the property transferred after the transfer; (3) whether the transfer or obligation was disclosed or concealed;(4) before the transfer was made or obligation was incurred, whether the debtor had been sued or threatened with suit; (5) whether the transfer was substantially all the debtor's assets; (6) whether the debtor absconded; (7) whether the debtor removed or concealed assets; (8) whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) whether the transfer occurred shortly before or shortly after a substantial debt was incurred; and (11) whether the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Comments to the UFTA state that in reviewing these elements, courts should consider all relevant factors negating as well as suggesting fraud.[17] Although these factors for consideration are codified, the list is not exclusive. No factor or set of factors need be given talismanic significance – they are only indicia, which by themselves or in combination with others may give rise to an inference of fraudulent intent.[18] Keep in mind that the burden of persuasion remains on the plaintiff to show actual intent by a "preponderance of the evidence."[19] Courts interpreting the Uniform Fraudulent Transfer Act have held that once a creditor establishes the existence of one or more of the eleven factors or non-listed factors then the burden shifts to the debtor to come forward with evidence that the transfer was not made to defraud the creditor.[20]

D. *Qualified Disclaimers*

There may be a legitimate way to protect your client or his family from creditors. Consider a qualified disclaimer. If your client makes a qualified disclaimer, the disclaimed interest in the property is treated as if it had never been transferred to the client.[21] The majority of courts across the country have held that a disclaimer, except for Medicaid or tax purposes, is not a "transfer" under the Fraudulent Conveyance Statute or the Statute of Frauds. The Colorado Court of Appeals in *Re Colacci Estate*,[22] held that a donee of a testamentary gift who was indebted to the testator for more than the value of his gift would be permitted to disclaim his interest so that his issue, who were not indebted to the estate, could take the gift undiminished by any claim or exercise of retainer by the administrator of the estate. There are stringent requirements under state and federal law to effectuate a proper disclaimer, including filing restrictions. Counsel should carefully review the law to ensure all requirements are met.

E. Conclusion

So how do I carry out my clients objectives and at the same time protect myself? After reading the *Young* and *Heiserman* cases some estate planners may be believe that it is better not to inquire as to their clients' existing or foreseeable creditors for fear that this knowledge may expose them to potential claims. However, it is doubtful that this "don't ask don't tell" approach would fully insulate a lawyer who assists a client in defrauding his or her creditors. When deposed by the creditor's attorney the estate planning attorney will certainly be asked why he or she did not inquire as to the client's assets and liabilities prior to the preparation of the estate plan and whether the attorney suspected that the client was deliberately hiding information. The failure to fully inquire as to the client's assets and liabilities may also expose the attorney to other types of claims when estate planning objectives fail.

Getting to know your client is paramount. After all, most estate planners would like to think that their client relationship is long term. This will require a candid conversation with the client to thoroughly understand his or her existing financial health as well as any foreseeable financial problems. Most estate planners require accurate information regarding clients' assets and liabilities.[23] The majority of clients understand this and are forthcoming with their financial information. Indeed, most estate planning questionnaires should require disclosure of this information. Client engagement letters should also advise the client that the attorney, without independent verification, will rely on the client to provide accurate information and that the failure to provide accurate information could result in failure to carry out the client's estate planning objectives. The client who is not forthcoming with information regarding his or her assets and liabilities may very well have a hidden agenda exposing the estate planning attorney to potential claims for aiding and abetting fraud. This is a person you may not want as your client. Finding a way to balance quality service to your client and protection of your practice is essential. While there is no foolproof way to accomplish this goal, you can remain cognizant of risks and the methods that may help minimize them.

[1]. *Snyder v. O'Conner*, 81 P.2d 773 (1938); *Newell v. Tubbs*, 84 P.2d 820 (1938); see also James R. Wade, *Wade/Parks – Colorado Law of Wills, Trusts and Fiduciary Administration*, § 32.39, Fifth Ed. (CLE in Colo. Inc. Supp. 2009). *Restatement (Second) of Trusts*, §§ 152 and 153 (1959); *Restatement (Third) of Trusts*, §§ 57 and 58 (2003); Uniform Trust Code § 502.

[2] *Holmes v. Young*, 885 P.2d 305, 308 (Colo.App.1994).

[3] *Alexander v. Anstine*, 128 P.3d 256 (Colo. App. 2005) *rev'd on other grounds*, 152 P.3d 497 (Colo. 2007).

[4] *Resolution Trust Corporation v. Heiserman, et al.* 898 P.2d 1049 (Colo. 1995).

[5] *People v. Rudman*, 948 P.2d 1022 (Colo. 1997).

[6] *Resolution Trust Corporation v. Heiserman*, supra. 898 P.2d 1049, 1055, 1056.

[7] *Resolution Trust Corporation v. Heiserman*, supra 898 P.2d 1049,1057, *citing* W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* Sec. 46, at 323-24 (5th ed. 1984).

[8] *Double Oak Constr., L.L.C. v. Cornerstone Dev. Int'l, L.L.C.*, 97 P.3d 140 (Colo. App. 2003) *cert. denied* (2004) (fraudulent conveyance); *Schneider v. Midtown Motor Co.*, 854 P.2d 1322 (Colo. App. 1992), *cert. denied* (1993).

[9] *Resolution Trust Corporation. v. Heiserman*, 898 P.2d 1049, 1054 (Colo. 1995) (breach of fiduciary duty); *Schneider*, 854 P.2d 1322 (negligent entrustment).

[10] *McElhanon v. Hing*, 728 P.2d 256 (Ariz. App. 1985); *Florida Bar v. Edward Rood*, 632 So.2d 1028 (Fla. 1993); *In Re Benson*, 854 P.2d 466 (Or. 1993); *In Re Carl L. Kenyon & Robert P. Lusk*, 491 S.E.2d 252 (S.C. Sup.Ct. 1997); *Banco Popular North America v. Gandhi*; 184 N.J. 161 (N.J. 2005); *Securities Exchange Com. v. Solow*, 682 F.Supp.2d 1312 (S.D. Fla. 2010); see also Mark Merric & Robert D. Gillen *Asset Protection for the Middle Class*, Trust and Estates (May 2010).

[11] Model Rule of Professional Conduct 1.2(d); see also Comment 9 "Criminal, Fraudulent and Prohibited Transactions".

[12] Model Rule of Professional Conduct 1.6; see also, *First Union National Bank v. Turney*, 824 So.2d 172 (Fla. App. 1st Dist. 2001).

[13] *Double Oak Constr. L.L.C. v. Cornerstone Dev. Int'l, L.L.C.*, 97 P.3d 140 (Colo. App. 2003); *Erjavec v. Herrick*, 827 P.2d 615 (Colo. App. 1992); see also Gideon Rothschild & Daniel S. Rubin, *Asset Protection Planning, Ethical? Legal? Obligatory?* Tr & Est. 42 (Sept. 2003)." As cited in David J. Slenn, *Has the Warning Bell Sounded for Asset Protection Planners?* Probate & Property (March/April 2010).

[14] C.R.S. § 38-8-108 Remedies of Creditors.

[15] C.R.S.§ 38-8-105(1).

[16] "Ethical Issues in Asset Protection Planning," program at the ABA RPTE/Taxation 2009 Joint Fall CLE Meeting, Chicago, Illinois, September 25, 2009.

[17] Uniform Fraudulent Transfers Act, § 4, cmt. (6).

[18] Frank R. Kennedy, *Uniform Fraudulent Transfers Act*, 18 U.C.C.L.J. 195, 201 (1986).

[19] *Morris v. Nance*, 132 Or.App. 216, 888 P.2d 571, 575-76 (1994).

[20] *Prairie Lakes Health Care Systems, Inc. v. Wookey*, 583 N.W.2d 405 (1996), citing as authority *Erjavec v. Herrick*, 827 P.2d 615, 617 (Colo. App. 1992) *superceded by statute is noted by In re Thomason*, 202 B.R. 268 (Bankr. D. Colo. 1996).

[21] Colorado Probate Code C.R.S. § 15-11-801(2); see also I.R.C. §2518 and Treas. Reg §25.2518-1.

[22] *Re Colacci Estate*, 37 Colo. App. 369, 549 P.2d 1096 (Colo. App. 1976) (*cert. granted*, 1976).

[23] Form 22, *Colorado Estate Planning Forms (Orange Book forms)*, Seventh Ed. (CLE in Colo., Inc. 2010).

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