

REAL ESTATE

Attorneys Must Be Wary of Fraudulent Conveyance

REAL ESTATE

BY ALAN NOCHUMSON

Special to the Legal

Attorneys who represent "deadbeat" clients may be unwittingly placing themselves in harm's way. In a recent federal court decision in Maryland, an attorney found she was personally liable to a lender after arranging two transfers of real estate for her clients.

In *Business Loan Express, LLC v. Pak*, while a confession of judgment action was pending against the guarantor of a defaulted loan, the defendant — the guarantors' child and attorney — formed a limited liability corporation transferring the guarantors' home and an investment property to the corporation. The corporation subsequently sold the home and transferred \$200,000 of the sales proceeds to the attorney's uncle in South Korea as payment for an alleged debt due by her parents. The lender later obtained a \$1.1 million judgment against the guarantors. After discovering the transfers of real estate during execution of the judgment, the lender sought to recover the full amount of the judgment from the attorney under Maryland's fraudulent conveyance statute.

Citing "unmistakable" badges of fraud in the two transactions, the federal court concluded that the lender was entitled to money damages from the attorney. Although the guarantors claimed they received consideration for the sale, the court pointed out that the attorney failed to present any evidence of a debt owed by her parents to her uncle.

The court also noted the "the only reasonable inference that can be drawn from the objective circumstantial evidence is that she and her parents ... act[ed] with fraudulent intent."

Based upon the finding the attorney used her professional skills to effectuate the transactions for her parents, the court ordered her to pay \$200,000 — the exact amount her parents transferred to the overseas relative — to the judgment creditor. The court limited the damages to that amount because there was no evidence the attorney helped her parents conceal or convey any other asset that would have been available to satisfy the judgment.

FRAUDULENT CONVEYANCE

While no Pennsylvania court has found an attorney liable for the debts of his clients, a recent Pennsylvania Superior Court decision may provide insight on whether this may change in the future. In *Presbyterian Medical Center v. Budd*, the Superior Court refused to recognize a cause of action under the Pennsylvania Fraudulent Transfer Act against a woman who allegedly made fraudulent trans-

fers as her mother's attorney-in-fact. The defendant's mother was a resident of the hospital at the time of her death. Prior to her death, the hospital sought to collect the mother's outstanding medical bills. The defendant then advised the hospital that her mother's resources were exhausted.

She then promised that she would file an application for medical assistance with the Commonwealth on her mother's behalf to pay for the medical bills. Knowing that her mother would not qualify for medical assistance because her resources exceeded the

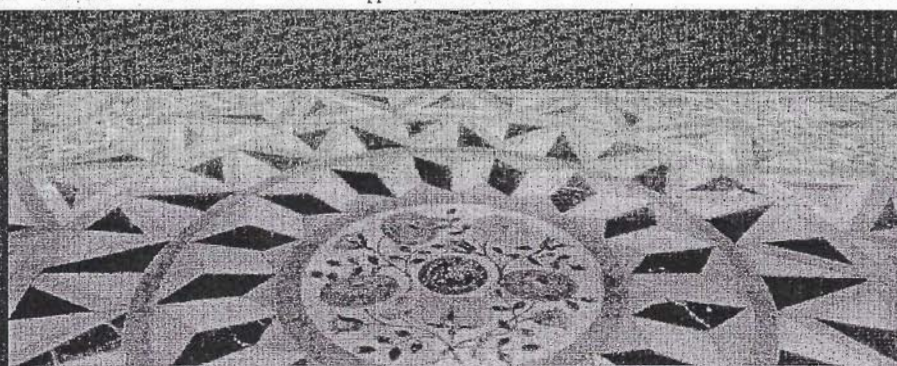
Commonwealth's maximum resource limit, she allegedly promised to spend down her mother's resources on medical expenses until her resources were depleted below the statutory limit. In exchange for this oral promise, the hospital refrained from attempting to bring her mother's account current.

Despite her promise, the defendant did not spend down her mother's resources on medical expenses, but instead used her power of attorney to transfer over her mother's assets to herself. After the Commonwealth rejected the mother's application because her assets

exceeded the threshold limit, the Commonwealth and the hospital reached a settlement agreement for less than the amount owed by her mother. The hospital then filed an action against the defendant under the PFTA claiming that the transferred assets could have been used to pay the hospital, her mother's creditor.

The trial court sustained the preliminary objections filed by the defendant on grounds that the PFTA does not apply to her as attorney-in-fact. Upholding the trial court's ruling,

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the Superior Court, pointing to the statutory language of the PFTA, concluded that the statute only protects creditors against fraudulent transfers made by "debtors." The court rejected the hospital's argument contending that the defendant's status as attorney-in-fact qualifies her as a "debtor," making her liable to the hospital for the allegedly fraudulent transfers. The court stressed that this Commonwealth has never recognized a PFTA claim targeting the attorney-in-fact of a debtor and refused to extend the PFTA beyond the plain language of the statute.

The *Budd* decision illustrates the fundamental difference between the PFTA and Maryland's fraudulent conveyance statute. Unlike the Maryland's fraudulent conveyance statute, the Pennsylvania version does not contain language providing that the statute applies to "every conveyance and every obligation incurred ... with actual intent" to defraud creditors.

Since an attorney-in-fact who was benefiting from the transactions was not held liable under the PFTA because she was not the "debtor," an attorney who was charging a reasonable amount for his services should be equally protected from liability. However, if the attorney was charging the client to pay a "bonus" for his legal services, a court may conclude that the attorney may be liable to the creditor for the portion of the legal fees that were not honestly earned.

The Superior Court in *Budd*, however, left open the possibility that a representative of a debtor may be liable under the PFTA without limitation. The Superior Court was intrigued by an Ohio appellate decision, which found an attorney-in-fact liable under similar circumstances. The Superior Court was, however, disappointed that the Ohio court did "not explain the particulars of its finding that the attorney-in-fact of a debtor qualified as a 'debtor.'" The Superior Court refused to similarly extend liability in *Budd* after concluding that the hospital had not pled sufficient facts to establish a convincing link under Pennsylvania law.

ATTORNEYS LIABILITY

While a creditor may not have a claim against an attorney under the PFTA, the attorney may still be liable under the common law tort of creditor fraud. In *Morganroth & Morganroth v. Norri McLaughlin & Marcus, P.C.*, the 3rd U.S. Circuit Court of Appeals, predicting New Jersey law, held that a plaintiff states a claim for creditor fraud under New Jersey law by alleging that an attorney has knowingly and intentionally participated in a client's unlawful conduct to hinder, delay or fraudulently obstruct the enforcement of a judgment.

In *Morganroth*, while the New Jersey law firm was representing its client in a \$6 million lawsuit for unpaid legal fees against an out-of-state law firm, the New Jersey firm helped the client transfer his interest in a 430-acre farm to one of his corporations for a nominal sum. The transfer was ultimately set

aside, and a judgment for the unpaid legal fees was entered in the underlying case. Undeterred, the New Jersey law firm then allegedly arranged to have stock owned by its client sent to a U.S. Marshall's office to facilitate an execution on a judgment owned by the client's brother, thereby becoming unavailable to satisfy the other judgment. The firm also allegedly drew up a fictitious lease, which leased back to the client, as his children's guardian, the interest just conveyed in the farm and then had the lease recorded by misrepresenting the facts to the county recorder.

Although the out-of-state law firm conceded that they had not stated a claim for common law fraud because the complaint did not contain any allegations of reliance on any misstatements actually made, they "assure[ed] they [we]re not required to allege reliance upon [mis]statements ... to make out a cause of action for creditor fraud because New Jersey case law provides a cause of action against a judgment debtor who fraudulently obstructs enforcement of a judgment."

Returning the case back to the district court for trial, the 3rd Circuit held that, assuming the allegations of the complaint were true, the New Jersey law firm's actions "went beyond the bounds of permissible advocacy," thus becoming an active participant in a scheme to obstruct execution of the underlying judgment.

Although no Pennsylvania court has ever recognized the tort of creditor fraud, the United States District Court for the Eastern District of Pennsylvania in *Corporate Aviation Concepts, Inc. v. General Electric Capital Corp.* recently discussed the tort in dicta. The district court stated that, even assuming if the Pennsylvania Supreme Court recognized this tort, the plaintiff failed to state a legally sufficient claim for creditor fraud.

Although the plaintiff alleged an outstanding debt owed by the defendant, the court pointed out that the debt was in the form of an unpaid obligation and not a money judgment. Since the plaintiff did not assert that it had obtained a judgment for this amount, or that the defendant intentionally obstructed the enforcement of any such judgment or liens, the district court found that the plaintiff had not established a *prima facie* case for creditor fraud.

A recent 3rd Circuit bankruptcy court decision clarified the narrowness of an attorney's duty to non-clients. The *In re Yacub* court found a New Jersey attorney, acting in his capacity as an attorney for a client, did not owe a duty under New Jersey law to a bank where the client was a guarantor.

The attorney prepared documents conveying the marital residence of his clients to their son. Without the attorney's knowledge, the bank sent a letter to the husband informing him of a default on a loan that he had guaranteed. When the attorney prepared the documents, he asked the husband whether there were any judgments, liens or claims against the husband and he was told there were none. The attorney did not ask if the husband was a borrower or guarantor

to any outstanding loans.

The 3rd Circuit found that the attorney did not have an independent duty to the bank. The court stated that the attorney did not affirmatively or implicitly take any action on behalf of the bank or make any representation to the bank or its attorneys, which he would expect that the bank would rely upon to its detriment.

At the time of the conveyance, the court reasoned that the attorney had no reason to foresee that the bank would be adversely affected. The court pointed out that nothing in the record indicated that the attorney made any representation or omission to the bank that would have prevented the bank from discovering the fraudulent conveyance.

Even if Pennsylvania ultimately decides to recognize the "creditor fraud" theory of recovery, an attorney would probably only be

liable if the attorney actively schemed with the client for the purpose of obstructing execution of a judgment already entered onto the books.

LESSONS LEARNED

Although the overall effect of the Maryland district court decision in *Pak* will most likely be viewed as a blip on the radar screen given the limited scope of the PFTA, Pennsylvania attorneys who help their clients obstruct collection efforts on a judgment may nonetheless be held accountable for the consequences of their actions under the tort of creditor fraud if Pennsylvania courts follow New Jersey's lead. Any attorney who fails to recognize the difference between zealous advocacy and unethical practice of the law could thus find himself personally on the receiving end of a lawsuit.

The Superior Court in Budd left open the possibility that a representative of a debtor may be liable under the PFTA without limitation.

AREA MORTGAGE RATES

Lender	Fixed Rates		Adjustable Rates		Jumbo Rates*		Commercial	
	30 yr.	15 yr.	30 yr.	15 yr.	1 yr.	30 yr. fixed	Yes/No**	
National Future Mtg. 800-291-7900	5.25/0	4.63/0	N/A	5.63/0	5.63/0	Yes		
AA E Mortgage 877-793-1400	5.25/0	4.63/0	N/A	5.63/0	No			
Lighthouse Mortgage 800-784-1331	5.25/0	4.63/0	N/A	5.63/0	No			
Amex Direct Lending 800-426-1027	5.63/0	4.88/0	N/A	5.88/0	No			
Madison Mortgage Services 888-897-0200	5.38/0	4.88/0	3.75/0	5.75/0	No			
Madison First Financial 888-516-4666	5.25/0	4.63/0	N/A	5.63/0	No			
Turnstone Mortgage 800-757-7514	5.38/0	4.75/0	2.88/0	5.75/0	No			
East Coast Financial 800-353-9440	5.50/0	4.88/0	N/A	5.88/0	No			
State Farm Bank 877-734-2265	5.75/0	5.25/0	4.25/0	5.88/0	No			
Wilmington Mortgage 610-558-3099	5.50/0	4.88/0	N/A	5.88/0	No			
Century Mortgage Corp. 800-224-7006	4.88/3	4.38/3	2.63/2	5.25/3	No			
American Family Mtg. 610-358-5324	4.75/2	4.13/3	3.38/3	4.75/3	No			

* A "Jumbo" or non-conforming mortgage is a loan amount in excess of \$333,700.
** Indicates if a lender offers mortgage loans for commercial properties. Call to discuss rates and terms.

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