Avoiding Sanctions: New Remedies and Warnings in Fraudulent Conveyance Law

By Daniel D. Mauler

This article is based on the author's interview with Sen. Chap Petersen, who sponsored the recent amendment to Virginia's fraudulent conveyance statutes.

In 2012, Senator J. Chapman "Chap" Petersen (D-Fairfax) sponsored legislation to amend Virginia's fraudulent conveyance statutes. It is no exaggeration to say that his amendment is one of the most significant developments in Virginia's fraudulent conveyance law that traces its history back over 400 years. Recently, I interviewed Sen. Petersen at his law office in Fairfax for his thoughts and the legislative intent behind the amendment.

Sen. Petersen's amendment offers a powerful new remedy against parties who structure fraudulent conveyances on behalf of other judgment debtors but who do not take title to the conveyed property themselves. This provides significant new opportunities for creditors' attorneys. But it also opens up serious liability for the attorney who knowingly assists a client in evading creditors. Young attorneys must be extremely wary the next time a judgment debtor seeks help to hide assets and evade creditors. If an attorney assists a debtor to evade a judgment, the attorney faces sanctions under the new amendment.

AMENDMENT INSPIRED BY THE TRAGIC CASE OF CRAIG AND MARY JO SANFORD

Today, Virginia lawyers are seeing more complicated schemes to fraudulently convey and hide the assets of judgment debtors. Usually, the assets are not real property, but instead, are items that can be easily hidden, disposed, or transferred. Moreover, these schemes are being devised by professionals (such as lawyers, accountants, or brokers) to assist their clients to hide assets. It was one particular scheme—complete with international intrigue, false identities, and a cameo appearance of the infamous Wikileaks documents[1] —that drove Sen. Petersen to sponsor the amendment.

In 2007, Craig and Mary Jo Sanford had just sold a successful small business and were looking forward to retirement. Interested in preserving their retirement assets, the couple was introduced to Jamie Smith, a person who held himself out as a CIA-trained veteran of military operations in the Middle East. Smith convinced the Sanfords to invest their retirement assets in his upstart-company which would provide training services to military and law enforcement personnel. The Sanfords never saw their money again. Represented by Sen. Petersen, the Sanfords sued Smith for fraud and won a $9.5 million jury verdict in a case tried before Judge Gerald Bruce Lee in the Eastern District of Virginia. The jury verdict against Smith was later affirmed by the Fourth Circuit.[2]

When the Sanfords attempted to collect on their judgment against Smith, he claimed that he had no assets, despite the fact that he continued to drive a Mercedes during the litigation. According to Sen. Petersen, Smith's assets had been transferred to his brother and his wife through a number of shell companies. Sen. Petersen recalls (with particular outrage) the involvement of an accountant working for Smith who masterminded the transfer of assets. Without the accountant's help, according to Sen. Petersen, Smith would not have successfully transferred his assets, leaving the Sanfords with an uncollectible judgment.

The Sanfords filed a subsequent suit for fraudulent conveyance, yet the accountant could not be held liable under the old § 55-80 because he was not a transferee of any fraudulently conveyed property.

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He had certainly participated in the conveyance, yet he never took title to the property. This struck Sen. Petersen as an injustice that required a change to Virginia's fraudulent conveyance law to ensure that such parties would face liability for

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their actions.[3]

VIRGINIA'S FRAUDULENT CONVEYANCE LAW TRACES ITS ROOTS 400 YEARS

To understand the significance of Sen. Petersen's amendment, an overview of Virginia's law of fraudulent conveyances is necessary. Virginia's law on the subject is hundreds of years old and dates back to Elizabethan England. The Commonwealth's fraudulent conveyance statute, codified at Va. Code § 55-80 through § 55-82.2, renders void any transaction by a debtor that is intended to "delay, hinder or defraud" a creditor. This language first appeared in the Statute of 13 Elizabeth, which was enacted by the English Parliament in 1571. One reason for passage was to prevent judgment debtors from transferring their property to family members or other confederates prior to seizure in payment of debts or obligations.[4] The statute provided liberal authority to courts of equity to set aside such transactions that were deemed fraudulent. "The statute [of 13 Elizabeth] is established for the suppression of fraud, the advancement of justice, and the promotion of the public good. Consequently, it should be liberally and beneficially construed to suppress the fraud, abridge the mischief, and enlarge the remedy."[5]

The Statute of 13 Elizabeth then migrated to the Colonies. "Virginia's present fraudulent conveyance statute is a modified version of 13 Elizabeth with minor variations."[6] In addition to Virginia, the same "hinder, delay, or defraud" language has been adopted, in some version or another, in most states and in the federal Bankruptcy Code.[7] Thus, the language originally drafted in 1571 "is the source of fraudulent disposition law in this country."[8]

One traditional remedy for a fraudulent conveyance was to "unwind" the transaction. Developed in cases dealing with real property, such a remedy was generally effective to return the debtor's assets to his creditors. This remedy made sense in the 16th through 19th centuries when a person's major asset was his land. The problem with this remedy in modern times becomes obvious, however, when the fraudulently-conveyed asset is not land, but instead is a fungible item (such as cash or personal property) that cannot be readily traced. How does one "unwind" a transaction involving assets that cannot be recovered or that no longer exist?

THE VIRGINIA SUPREME COURT RECOGNIZES ALTERNATIVE REMEDIES.

In response to this problem, the Supreme Court of Virginia recognized a new remedy in *Price v. Hawkins*.[9] In that case, a debtor fraudulently conveyed cash to his girlfriend and his two sons after he was hit with a significant judgment in a defamation lawsuit. After the girlfriend and sons received the cash from the debtor, they spent a significant portion of it. By the time the fraudulent conveyance lawsuit was filed, they had little or no cash to return to the creditor. During the subsequent fraudulent conveyance lawsuit, the transferees defended on the ground that they could not be liable because they no longer possessed the fraudulently-conveyed property.

The Supreme Court of Virginia rejected the defendants' argument. In doing so, the Court quoted a 50-year-old treatise on the subject and stated that a fraudulent transferee was "personally liable, on his account, for the value of the original property in case he cannot produce it or a substitute. Receiving the property fraudulently . . . the grantee is liable to the extent of its value."[10] The Court then looked to the history of the fraudulent conveyance statute and its equitable nature and pointed to two of its previous decisions that affirmed remedies fashioned by circuit courts that were not expressly authorized in the fraudulent conveyance statute.[11] In light of this, the Court affirmed the circuit court's imposition of money judgments against the transferees for the full amount of the cash that had been previously conveyed to them.

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Price represents an important development in fraudulent conveyance law where the Supreme Court of Virginia recognized that simply unwinding a transaction would not provide an adequate remedy in all cases. Instead, the Court focused on the equitable nature of the fraudulent conveyance statute by stating "[m]oreover, equity will not suffer a wrong to be without a remedy."[12] Invoking this traditional maxim, the Court noted that a circuit court may fashion a remedy to a fraudulent conveyance that is not expressly provided for in § 55-80.[13]

SEN. PETERSEN'S EXPANSION OF REMEDIES

Sen. Petersen's amendment is the next major development in the history of Virginia's fraudulent conveyance law, and it follows in the spirit of Court's expansion of remedies in *Price*. In 2012, Sen. Petersen sponsored SB 164 in the Virginia Senate, which inserted the following language into § 55-82.1: "Upon a finding of fraudulent conveyance pursuant to sec. 55-80, the court may assess sanctions, including such attorney fees, against all parties over which it has jurisdiction who, with the intent to defraud and having knowledge of the judgment, participated in the conveyance."

This amendment was overwhelmingly supported in the General Assembly, passing the Senate on a vote of 38-2 and a unanimous 99-0 vote in the House. After being signed by the governor, it went into effect on July 1, 2012.

The effect of the new language is to give courts the authority to award "sanctions" against any other person or party who participated in the fraudulent conveyance, regardless of whether they took title to the property or were a transferee.[14] Thus, the potential targets of sanctions are now firmly expanded beyond a mere transferor/transferee of the conveyed property. Since the Virginia Supreme Court has never addressed the question of whether non-transferees who participated in the fraudulent conveyance could be held liable under a conspiracy claim (though at least 18 other states permit such claims[15]), § 55-82.1 may be the most effective remedy against the perpetrators who participate in fraudulent conveyances.

According to Sen. Petersen, his amendment to § 55-82.1 was intended to be "as broad as possible," in terms of providing a remedy against those who had set up or facilitated a fraudulent conveyance but were not themselves transferees. If a person or entity helped set up the fraudulent conveyance, then they face potential liability as a "party" who participated in the conveyance. In Sen. Petersen's words, "It is very broad. 'Parties' in the statute means more than just transferees. Anyone who touched the transaction now faces liability, whether they're lawyers, real estate agents, or accountants. If you touch [the transaction], you're dirty."

Courtesy: Surovell Isaacs Petersen & Levy PLC.

Sen. Chap Petersen

Under § 55-82.1, the attorneys, accountants, or brokers who drafted the transfer documents or organized the accounts necessary for a fraudulent conveyance face liability under § 55-82.1. Attorneys—especially young attorneys starting out in practice—should be aware of potential liability if they help a client evade a creditor.

This raises the serious issue of what an attorney should do when a client has suffered a judgment. According to Sen. Petersen, "An attorney should be very careful when their client takes a judgment. In many ways, the attorney's relationship to the client changes at that point. Since the attorney knows about the judgment, if he counsels the client on how to evade it, then the attorney faces liability." Sen. Petersen's recommendation is that an attorney who represents a client facing a final judgment should counsel that client to enter payment negotiations with the creditor or to consider bankruptcy. According to Sen. Petersen, the attorney should refuse to help the client convey away assets simply to evade the judgment.

'Attorneys must be extremely careful to avoid assisting debtors to evade judgments, or else, the attorneys face liability themselves.'

Section 55-82.1 speaks in terms of "sanctions" against a participating party. Sen. Petersen said that the new amendment was intended to provide circuit courts "as wide latitude as possible. The idea is that the court would have maximum authority like it was sitting in equity" to fashion an appropriate remedy. According to Sen. Petersen, "[i]n most cases, the sanction would be an award of money damages against the parties involved . . . The sanctions are intended to make the victims whole [for the underlying judgment] so they can get on with their lives and to punish and deter anyone who helps another person evade a judgment."

Sen. Petersen also stressed the flexibility that the court has under the amendment and noted that the damage award does not have to be money. "It could be something else that the court thinks is appropriate." Such flexibility is consistent with the Supreme Court of Virginia's approval in previous cases[16] of remedies that are not expressly authorized in the fraudulent conveyance statute.

CONCLUSION

Virginia's fraudulent conveyance statute has a long history. It is remarkable that the Commonwealth's current statute contains the same language adopted in 1571. But it is also remarkable that this 400-year-old body of law was significantly expanded due to a real-world, modern-day attempt by a judgment debtor and his accomplices to evade paying a lawful judgment, which left a retired couple with no assets. Sen. Petersen has provided Virginia lawyers a new and important tool to combat an age-old problem, but it is also comes with a warning: Attorneys must be extremely careful to avoid assisting debtors to evade judgments, or else, the attorneys face liability themselves. ■

Endnotes:

1. Describing the complete, dramatic saga of the case of Craig and Mary Jo Sanford against Jamie Smith is beyond the scope of this article—but it makes for fascinating reading. *See*, *e.g.*, Ace Atkins & Michael Fechter, *Secret Agent Man*, Outside, Nov. 2014, at 90; Bill Sizemore, *His Company Defrauded Investors.Yet the Air force Kept Doing Business*, The Virginian-Pilot, July 25, 2012, at A1.
2. *See Sanford v. Smith*, 490 Fed. Appx. 570 (4th Cir. 2012).
3. The Supreme Court of Virginia has not answered the question of whether a cause of action for conspiracy may be based upon a fraudulent conveyance, though at least 18 other states allow such a claim. *See* Footnote 15 below.
4. *See* 1 Garrard Glenn, Fraudulent Conveyance and Preferences § 61b, at 90-91 (rev. ed. 1940).
5. Orlando Bump, Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors to Defraud Creditors 11-12 (3d ed. 1882).
6. Prof. Doug Rendleman, Enforcement of Judgments and Liens in Virginia 307 (1982).
7. 11 U.S.C. § 548(a)(1)(A) (West 2015) (prohibiting a debtor's voluntary or involuntary transfer "with actual intent to hinder, delay, or defraud" any creditor).
8. Prof. Peter A. Alces, The Law of Fraudulent Transactions § 1:13 (2012)
9. *Price v. Hawkins*, 247 Va. 32, 439 S.E.2d 382 (1994)
10. *Price*, 247 Va. at 36; 439 S.E.2d at 384 (*quoting* 1 Garrard Glenn, Fraudulent Conveyance and Preferences § 239, at 415 (rev. ed. 1940)).
11. *See Darden v. George G. Lee Co.*, 204 Va. 108, 129 S.E.2d 897 (1963); *Mills v. Miller Harness Co.*, 229 Va. 155, 326 S.E.2d 665 (1985).
12. *Price*, 247 Va. at 37; 439 S.E.2d at 385.
13. *Price*, 247 Va. at 37, 439 S.E.2d at 385 ("In *Darden* and *Mills*, the respective debtors had improperly preferred legitimate creditors to the detriment of another creditor. In those cases, ratable distribution, likewise a remedy not explicitly authorized by § 55-80, was appropriate under the circumstances.")
14. This is evident by the use of the term "parties" as opposed to "debtors" (used earlier in § 55-82.1) or "transferors" (used in the Voluntary Conveyance statute in § 55-81). Further, if the General Assembly intended "parties" to mean only transferors/transferees, then "against all parties over which it has jurisdiction who, with the intent to defraud and having knowledge of the judgment, participated in the conveyance" is mere surplusage and of no meaning. In short, "all parties" means something more expansive than debtors or transferees.
15. *See, e.g.*, *Janssen v. Lommen, Abdo, Cole, King & Stageberg, P.A.*, No. A14-0452, 2014 WL 7237121, at *4 (Minn. Ct. App. Dec. 22, 2014); *Essex Crane Rental Corp. v. Carter*, 371 S.W.3d 366, 379, 382 (Tex. App. 2012); *In re Allou Distributors, Inc.*, 379 B.R. 5, 36 (Bankr. E.D.N.Y. 2007) (applying New York law); *Tareco Properties, Inc. v. Morriss*, 196 F. App'x 358, 365 (6th Cir. 2006) (applying Tennessee law); *Banco Popular N. Am. v. Gandi*, 876 A.2d 253, 263 (N.J. 2005); *Qwest Commc'ns Corp. v.Weisz*, 278 F. Supp. 2d 1188, 1192-93 (S.D. Cal. 2003) (applying California law); *Summers v. Hagen*, 852 P.2d 1165, 1169 (Alaska 1993); *McElhanon v. Hing*, 728 P.2d 256 (Ariz. Ct. App. 1985); *Dalton v. Meister*, 239 N.W.2d 9 (WI 1976).
16. *See* Footnote 11 above. ■