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The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?

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The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?

Richard C. Ausness*

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INTRODUCTION

In recent years, a large number of Americans have established "asset protection trusts" in foreign countries. An asset protection trust is a self-settled spendthrift trust which is created in order to protect the settlor's property from the claims of creditors. Virtually all American jurisdictions recognize spendthrift trusts, which prohibit both voluntary and involuntary alienation of a third party beneficiary's interest in a trust; however, most do not allow a settlor who has retained a beneficial interest in a spendthrift trust to protect that interest from the claims of creditors. A growing number of present and former British possessions, however, have enacted laws that allow foreigners to create self-settled spendthrift or asset protection trusts in their territory. Although legal commentators disagree about the legitimacy of these offshore trusts, American courts have treated them with undisguised hos-

6. Cf. Barry S. Engel, Using Foreign Situs Trusts for Asset Protection Planning, 20 EST. PLAN. 212, 218 (1993) (stating that "the foreign situs asset protection trust can be a useful planning vehicle for wealthy people who wish to protect their assets from the perils of living in our modern-day society"), and Jonathan L. Mezrich, It's Better in the Bahamas: Asset Protection Trusts for the Pennsylvania Lawyer, 98 DICK. L. REV. 657, 675 (1994) (arguing that "asset protection is simply a reasonable reaction to today's 'court-happy' society, and should be allowed until the U.S. judiciary or legal community finds a way to reign-in [sic] damaging, frivolous lawsuits and litigiousness") with Randall J. Gingiss, Putting a Stop to "Asset Protection" Trusts, 51 BAYLOR L. REV. 987, 1033 (1999) (declaring that "[a]sset protection trusts, be they offshore or domestic, offend the public policy of the overwhelming majority of American states"), and Elena Marty-Nelson, Offshore Asset Protection
In this article, I argue that offshore asset protection trusts serve a legitimate purpose and, therefore, American courts should enforce them, at least when certain conditions are met. Specifically, the transfer of assets to the offshore trust must not be fraudulent; the settlor should not retain any beneficial interest in the trust other than a reversion; the settlor should not retain a power of appointment nor act as trustee or trust protector; the settlor should retain a copy of the trust instrument; and the trust instrument should require the trustee to render periodic accountings to the settlor and all trust beneficiaries. If these conditions are satisfied, a domestic court should apply the law of the trust situs and recognize the validity of the offshore trust.

Part I of this article analyzes the law applicable to domestic spendthrift trusts and describes the characteristics of a typical offshore asset protection trust. This portion of the article also surveys recent legislation that allows the establishment of asset protection trusts in some American jurisdictions. In Part II, I examine a number of decisions in which American courts have attempted to undermine the effectiveness of offshore asset protection trusts. These cases have involved domestic fraudulent transfer laws, jurisdiction and choice of law issues, protective devices in offshore trusts and the formulation of remedies to strengthen the hand of domestic creditors. Finally, in Part III, I consider the policy arguments for and against the recognition of offshore asset protection trusts, and propose an approach for American courts to adopt.

I. AN INTRODUCTION TO OFFSHORE ASSET PROTECTION TRUSTS

An offshore asset protection trust is a form of spendthrift trust that is established in a foreign country. Unlike the rule in the United States, many foreign jurisdictions recognize "self-settled" spendthrift trusts, that is, trusts which are designed to protect the settlor from the claims of creditors. In this portion of the article, I will review the law applicable to spendthrift trusts in America and

Trusts: Having Your Cake and Eating It Too, 47 RUTGERS L. REV. 11, 80 (1994) (contending that offshore asset protection trusts "invite U.S. settlors to defeat deep-seated public policy in this country").

7. E.g., Fed. Trade Comm'n v. Affordable Media, LLC, 179 F.3d 1228, 1240 (9th Cir. 1999) (declaring that "[t]he 'asset protection' aspect of these foreign trusts arises from the ability of people . . . to frustrate and impede the United States courts by moving their assets beyond those courts' jurisdictions"); Breitenstine v. Breitenstine, 62 P.2d 587, 593 (Wyo. 2003) (stating that "the use of such trusts to avoid alimony, child support and a fair division of marital property upon divorce is reprehensible to us").
will also examine some of the salient features of offshore trusts. Additionally, this article will consider recent legislation recognizing domestic self-settled spendthrift trusts.

A. Spendthrift Trusts

Ordinarily, a trust beneficiary can voluntarily transfer his or her interest in a trust. Furthermore, a creditor of the beneficiary can attach or execute upon such an interest to satisfy a debt. However, in most states the settlor can restrict alienation of a beneficial interest in the trust by making the trust a spendthrift trust. A spendthrift trust prohibits a trust beneficiary from voluntarily transferring an interest to a third party and prevents creditors of a beneficiary from reaching the beneficiary's interest in the trust through garnishment or attachment. Of course, the spendthrift clause does not protect against creditors once funds are distributed by the trustee to a beneficiary.

However, spendthrift trusts do not provide complete protection against creditors' claims. Alimony creditors, support creditors, providers of necessary goods and services, and government entities may be able to reach a debtor's interest in a spendthrift trust. For example, state courts and statutes frequently allow children of the beneficiary to reach the assets of spendthrift trusts for child support. Alimony claimants may sometimes reach a

beneficiary’s interest in a spendthrift trust as well. 15 In addition, providers of necessary goods and services may be allowed to reach a beneficiary’s interest in a spendthrift trust for payment. 16 Finally, claims against a trust beneficiary by a government entity for unpaid taxes can sometimes be recovered against a beneficiary’s interest in a spendthrift trust. 17

Creditors can also reach a beneficiary’s interest in a self-settled spendthrift trust. 18 Although there is nothing to prevent a settlor from establishing a self-settled trust, 19 almost all courts refuse to enforce spendthrift provisions in self-settled trusts where the settlor has retained a beneficial interest, at least as far as that interest is concerned. 20 This rule has been endorsed by the Uniform Trust Code (UTC) 21 and the Restatement (Third) of Trusts. 22


18. This rule also applies to both discretionary trusts and support trusts. See Menotte v. Brown, 303 F.3d 1261, 1271 (11th Cir. 2002) (support trust); In re Robins, 826 F.2d 293, 295 (4th Cir. 1987) (support trust); Greenwich Trust Co. v. Tyson, 27 A.2d 166, 173 (Conn. 1942) (discretionary trust); Ware v. Guida, 117 N.E.2d 137, 138 (Mass. 1954) (discretionary trust); In re Hortsberg Inter Vivos Trust, 578 N.W.2d 289, 291 (Mich. 1998) (discretionary trust); McKeon v. Dept. of Mental Health, 479 N.W.2d 25, 28 (Mich. Ct. App. 1991) (discretionary trust).


Most courts apply this rule even if the settlor did not intend to defraud creditors when the trust was created.\textsuperscript{23}

\subsection*{B. Offshore Asset Protection Trusts}

Because domestic spendthrift trusts, especially self-settled ones, do not provide sufficient protection against the claims of creditors, an increasing number of wealthy Americans have turned to offshore asset protection trusts as an alternative.\textsuperscript{24} An offshore asset protection trust is a trust that a domestic settlor establishes in a foreign jurisdiction to achieve some measure of protection against the claims of domestic creditors.\textsuperscript{25} Some of the more popular locations for offshore asset protection trusts are Anguilla, the Bahamas, Barbados, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Cook Islands, Cyprus, Gibraltar, the Isle of Man, Jersey, Mauritius, Niue, Saint Kitts and Nevis, and the Turks and Caicos Islands.\textsuperscript{26} All of these are present or former British possessions where English is spoken and English common law is recognized.\textsuperscript{27}

\begin{footnotesize}
  \textsuperscript{23} In re Cohen, 8 P.3d 429, 434 (Colo. 1999); Nagel, 580 N.W.2d at 811-12; Farmers State Bank, 410 N.W.2d at 190.
  \textsuperscript{24} Giles, supra note 1, at 639.
  \textsuperscript{26} Engel, supra note 6, at 213.
\end{footnotesize}
Typically, offshore asset protection trusts have several common characteristics. First, the settlor will not retain any beneficial

prized of sixteen inhabited and more than twenty uninhabited islands in the Caribbean Sea east of Puerto Rico. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/vi.html (last visited July 28, 2006). The British Virgin Islands are about 59 square miles in area and are a British Overseas Territory. Id. The economy depends heavily on tourism, and a large number of foreign companies are now incorporated there. Id. The Cayman Islands, a British Overseas Territory, are located about 145 miles south of Cuba and 160 miles northwest of Jamaica. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/cj.html (last visited July 28, 2006). The islands are about 100 square miles in size and have a population of 45,436. Id. Tourism is an important industry. Id. In addition, more than 40,000 companies are now registered in the Cayman Islands, including almost 600 banks and trust companies. Id. The Cook Islands, a group of fifteen islands located in the southern Pacific Ocean between Hawaii and New Zealand, are self-governing, but are affiliated with New Zealand. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/cj.html (last visited July 28, 2006). The islands are only 92.6 square miles in area and have a population of 21,388. Id. They export copra, fresh and processed fruit, clothing and handicrafts. Id. Cyprus, a large island in the eastern Mediterranean Sea south of Turkey, obtained its independence from Great Britain in 1960. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/cy.html (last visited July 28, 2006). The island is 3570 square miles in area, and its population is 784,301. Id. The Cypriot economy is primarily based on tourism and financial services. Id. Gibraltar is a British Overseas Territory located on the southern coast of Spain directly across from Morocco. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/gi.html (last visited July 28, 2006). Gibraltar is only 2.5 square miles in area and has a population of 27,928. Id. Its economy benefits from shipping, offshore banking and tourism. Id. The Isle of Man, located in the Irish Sea between Great Britain and Ireland, is a British crown dependency, but is not part of the United Kingdom. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/im.html (last visited July 28, 2006). It is approximately 221 square miles in area and has a population of 75,441. Id. Offshore banking, manufacturing and tourism have replaced agriculture and fishing as major contributors to the economy. Id. Jersey, another British crown dependency, is located in the English Channel northwest of France. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/je.html (last visited July 28, 2006). The island is about 45 square miles in area and has a population of 91,084. Id. Its economy is based on international financial services, agriculture and tourism. Id. Mauritius, an island located in the Indian Ocean east of Madagascar, obtained its independence from Great Britain in 1968. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/mp.html (last visited July 28, 2006). Mauritius is about 787 square miles in area and has a population of 1,240,827. Id. In addition to its textile and tourism industry, Mauritius has expanded its local financial institutions and has attracted more than 9,000 offshore entities, many of which trade with India and South Africa. Id. Saint Kitts and Nevis are two Caribbean islands located between Puerto Rico and Trinidad. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/sc.html (last visited July 28, 2006). A former British colony, Saint Kitts and Nevis achieved independence in 1983. Id. The islands are about 100 square miles in area and have a combined population of 39,129. Id. Sugar production is still the primary industry; tourism, export-oriented manufacturing and offshore banking are now important segments of the islands’ economy. Id. The Turks and Caicos Islands, a British Overseas Territory, consist of two island groups in the Caribbean Sea southeast of the Bahamas and north of Haiti. The World Factbook, http://www.cia.gov/cia/publications/factbook/geos/tk.html (last visited July 28, 2006). The islands’ total area is 166 square miles, and their population is 21,152. Id. The economy is based on tourism, fishing and offshore financial services. Id.
interest in the trust other than a contingent reversionary interest, and the trust will be irrevocable, thereby leaving no interest for creditors to reach. In addition, the trust will either terminate after a fixed number of years with a reversionary interest in the settlor, or after a longer period based on the lives of the settlor or the trust’s beneficiaries. Normally, the settlor will not act as trustee; instead, the trustee will be a foreign trust company or financial institution. The trust will give the trustee sole discretion to distribute trust income or principal to named beneficiaries, such as the settlor’s spouse or children. Also, the trust will state that the situs of the trust will govern the trust provisions.

Properly drafted offshore asset protection trusts can provide settlors with a high degree of protection against the claims of creditors. First of all, American courts usually cannot obtain personal jurisdiction over a foreign trustee. In addition, most foreign jurisdictions will not enforce judgments obtained in an American court. Instead, creditors must travel to the country where the trust is located and litigate their claims under foreign laws. In most of these jurisdictions, contingent fees are not allowed, and foreign attorneys often demand that their fees be paid in advance. Furthermore, if there is litigation, the loser must pay all court costs.

Moreover, asset protection trusts are governed by the substantive laws and procedures of the situs jurisdiction, which are often highly favorable to debtors. For example, fraudulent transfer laws in these jurisdictions often require creditors to prove that the

30. Marty-Nelson, supra note 6, at 13. If the settlor acts as trustee, an American court may order him to exercise his discretionary powers as trustee to distribute trust funds to himself and thus to his creditors. Id.
31. Brown, supra note 5, at 134.
33. Brown, supra note 5, at 134.
35. Roder, supra note 32, at 1256.
36. Brennan, supra note 25, at 768.
38. Taylor, supra note 2, at 172.
39. Lorenzetti, supra note 28, at 140.
settlor actually intended to "delay, hinder or defraud" them. In addition, these jurisdictions require a higher standard of proof than is normally required for civil litigants in American courts. Furthermore, the statute of limitations in many foreign jurisdictions begins to run at the time of the transfer and usually expires within a year or two thereafter. Consequently, by the time a creditor finds out where the debtor's property is located, the local statute of limitations often will have run, effectively barring suit in the trust situs jurisdiction.

The typical asset protection trust will contain a number of protective devices that will enable the settlor to exercise some control over the trust property and protect against adverse changes in circumstances. These include: (1) a trust protector clause, (2) an anti-duress clause, (3) a flight clause, (4) and a non-binding letter of intent.

A trust protector is someone who is appointed by the settlor to act as an advisor to the trustee and who is charged with making sure that the trustee carries out the settlor's wishes. In some cases, the consent of the protector may be necessary for the trustee to perform certain acts. In addition, the protector may be empowered to remove the trustee, change the beneficiaries or even change the situs of the trust.

An anti-duress clause prohibits the trustee from complying with any order imposed upon the settlor, a domestic trustee or the foreign trustee. The trust instrument will identify the circumstances which will trigger the anti-duress clause, including an order from an American court directed at the trustee. In such cases, the anti-duress clause may instruct the foreign trustee to remove any co-trustees who may be subject to personal jurisdiction in an American court. The anti-duress clause will also

40. Brennan, supra note 25, at 768.
42. Marty-Nelson, supra note 6, at 61.
44. Lorenzetti, supra note 28, at 149.
46. Roder, supra note 32, at 1256.
47. Lorenzetti, supra note 28, at 146.
49. Lorenzetti, supra note 28, at 146.
automatically terminate any powers retained by the settlor over the trust and transfer them to the foreign trustee.\textsuperscript{50}

Another common provision is a flight clause, which empowers the trustee to take whatever actions are necessary in order to protect the trust's assets against threats of nationalization, expropriation or political instability.\textsuperscript{51} A flight clause can change the trustee or authorize the trustee to transfer the trust corpus to another jurisdiction.\textsuperscript{52}

Finally, the settlor can draft a non-binding letter in which the settlor expresses his intentions as to the disposition of the trust property.\textsuperscript{53} Although the trustee can theoretically ignore the settlor's wishes, if this occurs the trust protector can override or remove the trustee.\textsuperscript{54}

C. \textit{Domestic Asset Protection Trusts}

On April 1, 1997, Alaska became the first state to enact asset protection trust legislation.\textsuperscript{55} Delaware enacted similar legislation on July 9, 1997.\textsuperscript{56} Since then, Missouri,\textsuperscript{57} Nevada,\textsuperscript{58} Oklahoma,\textsuperscript{59} Rhode Island,\textsuperscript{60} Utah\textsuperscript{61} and possibly Colorado\textsuperscript{62} have followed suit. Statutes in these states typically provide that the

\begin{itemize}
\item Brennan, supra note 25, at 766.
\item Taylor, supra note 2, at 174.
\item Brown, supra note 5, at 134.
\item Lorenzetti, supra note 28, at 149.
\item Delaware Qualified Disposition in Trust Act, DEL. CODE ANN. tit. 12, §§ 3570-76 (2001).
\item Mo. ANN. STAT. § 456.5-505(3) (Supp. 2006).
\item Nevada Spendthrift Trust Act, NEV. REV. STAT. §§ 166.010-166.170 (2005).
\item Qualified Dispositions in Trust Act, R.I. GEN. LAWS §§ 18-9.2-1 to 18-9.2-7 (2003).
\item UTAH CODE ANN. § 25-6-14 (Supp. 2004).
\item \textit{In re Baum}, 22 F.3d 1014 (10th Cir. 1994). In the \textit{Baum} case, the settlor, who was experiencing marital difficulties, created two irrevocable inter vivos trusts and transferred his residence and various antiques and other tangible personal property to the trusts. \textit{Baum}, 22 F.3d at 1015-16. The purpose of the trusts was to provide for the settlor's children by a prior marriage in the event of a divorce. \textit{Id.} at 1018. The children were the principal beneficiaries of the trust, although the settlor retained the right to live in a family residence that had been transferred to the trusts. \textit{Id.} at 1015-16. Several years later, the settlor declared bankruptcy, and the bankruptcy trustee argued that the trusts' assets should be included in the settlor's bankruptcy estate. \textit{Id.} at 1016. However, a federal appeals court upheld the validity of both irrevocable inter vivos trusts and refused to include their assets in the settlor's bankruptcy estate even though the settlor had retained a beneficial interest in the trusts. \textit{Id.} at 1018-20.
\end{itemize}
trust have at least one trustee in the situs state, that the trust operate under the laws of the host state, that some or all of the administration of the trust take place in the host state, and that part or all of the trust property be deposited or held within the host state. Some of these statutes authorize the trustee to make discretionary distributions of income or principal to the settlor. In other cases, "trust advisors," including the settlor, have the authority to remove trustees or veto any distributions from the trust. The settlor may be given a testamentary special power of appointment over the trust. In some states, the settlor may even retain a mandatory right to receive income (but not principal) from the trust without losing the protection of the spendthrift provision. Furthermore, many of these statutes require proof of actual fraud in fraudulent transfer claims and reject the concept of constructive fraud. They also have short limitation periods for fraudulent transfer claims. Finally, several states have also codified their conflict of law standards by statute.

A domestic asset protection trust is similar to an offshore asset protection trust, but offers domestic substantive and procedural law and greater convenience. A domestic asset protection trust also avoids the complications and uncertainties associated with establishing a trust in a country that may have a foreign language and a different social culture, political system, legal system and

63. See, e.g., ALASKA STAT. § 13.36.035(c)(2) (2004); DEL. CODE ANN. tit. 12, § 3570(9)(a) (2001); NEV. REV. STAT. § 166.015(2)(a)-(c) (2005).
64. See, e.g., ALASKA STAT. § 13.36.035(d); DEL. CODE ANN. tit. 12, § 3570(10)(a); NEV. REV. STAT. §§ 166.015(1), 166.070; R.I. GEN. LAWS § 18-9.2-2(9)(i); UTAH CODE ANN. § 25-6-14(1)(a).
65. See, e.g., ALASKA STAT. § 13.36.035(c)(4); NEV. REV. STAT. § 166.015(1)(d).
66. See, e.g., ALASKA STAT. § 13.36.035(c)(1); DEL. CODE ANN. tit. 12, § 3570 (9)(b); NEV. REV. STAT. § 166.015(1)(a)-(b); R.I. GEN. LAWS § 18-9.2-2(8)(ii); UTAH CODE ANN. § 25-6-14(1)(a).
67. See, e.g., ALASKA STAT. § 34.40.110(b)(2) (2004); DEL. CODE ANN. tit. 12, §§ 3571, 3572(a) (2001); NEV. REV. STAT. § 166.040(1)(b), (2)(b) (2005); R.I. GEN. LAWS § 18-9.2-3; UTAH CODE ANN. § 25-6-14(2)(e)(ii).
68. See, e.g., ALASKA STAT. § 13.36.370(b)(1) (2004); DEL. CODE ANN. tit. 12, § 3570(9)(c)(1); UTAH CODE ANN. § 25-6-14(2)(e)(iv).
69. See, e.g., ALASKA STAT. § 34.40.110(b)(2); DEL. CODE ANN. tit. 12, § 3570(10)(b)(2); NEV. REV. STAT. § 166.040(2)(a); R.I. GEN. LAWS § 18-9.2-2 (9)(ii)(B); UTAH CODE ANN. § 25-6-14(2)(e)(ii).
70. See, e.g., ALASKA STAT. § 34.40.110(b)(3)(B); DEL. CODE ANN. tit. 12, § 3570(10)(b).
71. See, e.g., ALASKA STAT. § 34.40.010 (2004); UTAH CODE ANN. § 25-6-14(2)(c)(ii).
72. See, e.g., ALASKA STAT. § 34.40.110(d)(1) (4 years); DEL. CODE ANN. tit. 12, § 3572(b)(2) (4 years); NEV. REV. STAT. § 166.170(a) (2005) (2 years); R.I. GEN. LAWS § 18-9.2-4(b)(1) (4 years); UTAH CODE ANN. § 25-6-14(2)(c)(i) (3 years).
73. See, e.g., ALASKA STAT. § 13.36.035 (2004); DEL. CODE ANN. tit. 12, § 3572(e); NEV. REV. STAT. § 166.015 (2005).
74. Pallbearers to Liability, supra note 45, at 515.
currency. On the other hand, domestic asset protection trusts lack some of the key procedural and statutory benefits that provide a strong anti-litigation foundation to the offshore trusts, as well as the benefit of being able to exercise some indirect supervision over the disposition of the trust.

II. OFFSHORE ASSET PROTECTION TRUSTS IN THE COURTS

In this part of the article, I shall describe the negative treatment accorded offshore asset protection trusts by American courts. These cases have involved a variety of issues, including fraudulent transfer laws, jurisdiction and choice of law questions, remedies and the validity of protective provisions in offshore trusts. In general, American courts have done their best to thwart attempts by settlors to protect themselves against the claims of domestic creditors.

A. Application of Fraudulent Transfer Laws

Fraudulent transfer laws, which exist in every state, prohibit a debtor from transferring assets in order to hinder, delay or defraud creditors. If a court concludes that a transfer is fraudulent, it will set aside the transfer and allow the creditor to satisfy the debt from the transferred property. Most states have adopted the Uniform Fraudulent Transfer Act (UFTA), but some adhere to the Uniform Fraudulent Conveyance Act (UFCA) or to the older Statute of Elizabeth.

A few states still follow the sixteenth century Statute of Elizabeth, which prohibits debtors from transferring their property with "the intent to delay, hinder or defraud creditors or others of their just and lawful actions." The statute requires an actual intent to defraud, but allows circumstantial proof of the debtor's subjective state of mind by means of one or more "badges of

75. Id.
77. Wagenfeld, supra note 29, at 845.
78. Lorenzetti, supra note 28, at 157.
80. 13 Eliz., ch. 5 § 1 (1571).
81. Pallbearers to Liability, supra note 45, at 509.
A badge of fraud is “a fact [that tends] to throw suspicion upon the questioned transaction, excites distrust as to bona fides, raises an inference that a conveyance is fraudulent, and by its presence, usually requires a showing of good faith.” Badges of fraud include: (1) lack or inadequacy of consideration; (2) a familial or other close relationship among the parties; (3) the retention of possession, benefit or use of the property by the debtor; (4) the financial condition of the debtor before and after the transfer; (5) the existence or effect of a pattern of transactions or course of conduct after the onset of financial difficulties; and (6) the general chronology of events. In some cases, even a single badge of fraud may be enough to establish that a transfer is fraudulent.

The Uniform Fraudulent Conveyance Act, which was promulgated in 1918 by the National Conference of Commissioners of Uniform State Laws, protects not only those who are creditors at the time of the transfer but also extends protection to “future creditors” of the defendant. The UFCA also recognizes the concept of “constructive fraud,” which involves a transaction that harms the transferor’s creditors without regard for the transferor’s subjective intent. Under the concept of constructive fraud, the UFCA will invalidate conveyances that occur without consideration when the debtor is insolvent or becomes insolvent as a result of the transfer, the debtor is left with a small amount of capital, and when the debtor intends or believes that he will be unable to pay his debts.

Most states have now adopted the Uniform Fraudulent Transfer Act, promulgated by the National Conference of Commissioners of Uniform State Laws in 1984. The UFTA allows both present and future creditors to reach property that was transferred with actual intent to defraud any creditor of the debtor. The statute also enumerates various badges of fraud that may be used to

84. Marty-Nelson, supra note 6, at 54.
85. Reed, 566 P.2d at 590.
86. Race to the Bottom, supra note 82, at 1045-46.
87. UNIF. FRAUDULENT CONVEYANCE ACT §§ 4-6 (1918).
88. Id.
prove the debtor's actual intent.\textsuperscript{91} Present and future creditors may also invalidate constructively fraudulent transfers when the debtor is involved in a business or transaction that would leave him with a small amount of capital, or when the debtor intended, believed or reasonably should have believed that he would incur debts that he would be unable to pay.\textsuperscript{92} Finally, present (but not future) creditors may prove that a transfer was fraudulent, regardless of the debtor's intent, if the transfer was made for less than reasonably equivalent value while the debtor was insolvent, or if an insolvent debtor made a transfer to an insider for a previous debt and the insider reasonably believed that the debtor was insolvent.\textsuperscript{93}

American courts have relied on the badges of fraud and the concept of constructive fraud to conclude that a transfer of property to an offshore trust was fraudulent. For example, a Wyoming court employed a "badges of fraud" analysis in Breitenstine \textit{v.} Breitenstine\textsuperscript{94} to prevent the settlor of an offshore asset protection trust from withholding assets from his spouse in a divorce proceeding.\textsuperscript{95} In that case, Jerald Breitenstine appealed the property division ordered by the court in conjunction with his divorce, contending that much of the property that was awarded to his wife was not marital property.\textsuperscript{96} After marital problems began to develop in 1995, Mr. Breitenstine transferred large amounts of marital and inherited property to the Breitenstine Family Trust that he established in the Bahamas.\textsuperscript{97} After deciding that property Mr. Breitenstine had received from his parents could be awarded to his spouse,\textsuperscript{98} the Wyoming Supreme Court considered whether a fraudulent transfer had occurred when Breitenstine created an asset protection trust in the Bahamas.\textsuperscript{99}

Wyoming's fraudulent transfer statute, based on the UFCA, provided that any transfer made with actual intent to hinder, delay, or defraud either present or future creditors would be treated as fraudulent.\textsuperscript{100} The court observed that the determining factor

\begin{footnotesize}
\begin{enumerate}
\item Id. § 4(b).
\item Id. § 4(a)(2).
\item Id. § 5.
\item 62 P.3d 587 (Wyo. 2003).
\item \textit{Breitenstine}, 62 P.3d at 587.
\item Id. at 589.
\item Id. at 590-93.
\item Id. at 590.
\item Id. at 592-94.
\item WYO. STAT. ANN. § 34-14-108 (repealed 2006).
\end{enumerate}
\end{footnotesize}
was the husband's intent at the time of the transfer, which could be proved by circumstantial evidence. The court identified a number of badges of fraud and concluded that many of them were present in the circumstances surrounding the creation of Breitenstine's offshore trust. Specifically, the court noted that the husband would receive all of the trust property when it terminated in 2005 and could name himself as a beneficiary even sooner. In addition, the husband retained complete control over the trust by naming a long-time family friend as trust protector. Finally, the timing of the transfer was suspicious. The husband transferred most of the family’s property to the Bahamas after he and his wife had separated and were likely to seek a divorce in the near future. For these reasons, the court concluded that Breitenstine’s transfers to the Bahamian trust in 1995 were fraudulent.

In 2003, another American court relied on the concept of constructive fraud in *Nastro v. D’Onofrio* to uphold the claims of a domestic creditor where a debtor had transferred property to an offshore trust. The parties owned a company known as U.S. Propeller Service of California. On June 7, 2001, Nastro obtained a judgment in California against D’Onofrio for misappropriation of the corporation’s funds. On June 21, 2001, D’Onofrio transferred $650,000 worth of stock in various Connecticut-based companies to a trust company in the Channel Island of Jersey for the benefit of his wife and children. In 2002, Nastro filed an action in a federal district court in Connecticut, seeking injunctive relief against D’Onofrio. Nastro alleged that D’Onofrio’s transfer of stock to the Jersey trustee without consideration left D’Onofrio without sufficient assets to pay the California judgment. D’Onofrio sought to dismiss the suit, but the court concluded that there was evidence of constructive fraud under the

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102. *Id.* at 593.
103. *Id.*
104. *Id.* at 593-94.
105. *Id.* at 594.
109. *Id.* at 448.
110. *Id.*
111. *Id.* at 449.
112. *Id.*
UFTA. The transfer was gratuitous, it rendered D’Onofrio insolvent and unable to pay his debt to Nastro, and the transfer took place just two weeks after a judgment against D’Onofrio was rendered by the California court. Accordingly, the court granted a preliminary injunction against D’Onofrio, preserving status quo during the litigation.

A fraudulent transfer statute can be a useful tool for creditors when the settlor transfers property to an offshore trust. As the Breitenstine and Nastro cases illustrate, courts that are hostile to the concept of self-settled spendthrift trusts can employ concepts like badges of fraud or constructive fraud to characterize transfers of property to offshore trusts as fraudulent. If the court finds a transfer to be fraudulent, it can try to force the settlor to repatriate the trust corpus and subject it to creditors’ claims.

**B. Jurisdiction and Choice of Law Issues**

In order to reach the assets of an offshore trust, a creditor must obtain either personal jurisdiction over the foreign trustee (assuming that there is no domestic trustee) or in rem jurisdiction over the trust property if it is located within the domestic court’s jurisdiction. Although lack of jurisdiction has derailed some lawsuits, American courts have often cooperated with creditors to overcome jurisdictional problems, particularly when they were able to exercise personal jurisdiction over the settlor. American courts have also been sympathetic to creditors when choice of law issues arise. Almost without exception, American courts have chosen to apply the law of the forum instead of the law of the trust situs (where self-settled spendthrift trusts are recognized), even though the trust instrument expressly provided that the law of the trust situs should be applied.

1. **Jurisdiction**

Due process forbids the imposition of a judgment by a court unless it has obtained jurisdiction over either the parties or over the property in dispute. A judgment imposed in violation of these requirements is void in the state where it is rendered, and due process forbids recognition and enforcement of such a judg-

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114. Id. at 460.
115. Id. at 460-61.
ment in any other state as well.\textsuperscript{117} A court may assert in rem jurisdiction when trust property is located in the forum state\textsuperscript{118} or it may exercise personal jurisdiction over a trustee if he or she resides in the forum state.\textsuperscript{119} In some cases, a court may also employ a state's long-arm statute to assert personal jurisdiction over trustees, even if they do not reside in the forum state.

\textit{International Shoe Co. v. State of Washington}\textsuperscript{120} is the foundation of modern jurisdictional theory. In that case, the United States Supreme Court held that a non-resident defendant can be subject to personal jurisdiction if he has "minimum contacts" with the forum state and the maintenance of a suit in the forum state would not offend "traditional notions of fair play and substantial justice."\textsuperscript{121}

The Court's minimum contacts analysis was applied to an out-of-state trustee in \textit{Hanson v. Denckla}.\textsuperscript{122} In that case, the Court concluded that a Florida court could not exercise jurisdiction over a Delaware trust that had been established by the settlor while she was living in Pennsylvania.\textsuperscript{123} The settlor retained an income interest under the trust as well as the right to amend the trust and to exercise a general power of appointment over the trust corpus. She later moved to Florida and appointed $400,000 from the trust for the benefit of two of her grandchildren.\textsuperscript{124}

At her death, the residuary legatees under her will brought suit in a Florida court to challenge the validity of the Delaware trust. The Florida Supreme Court ruled in favor of the residuary legatees,\textsuperscript{125} but the Delaware Supreme Court refused to recognize the Florida judgment because it believed that the Florida court lacked personal jurisdiction over the Delaware trustee.\textsuperscript{126} On appeal, the United States Supreme Court held that the Delaware court did not have to honor the Florida court's ruling on the validity of the trust because the Florida court failed to obtain either personal

\textsuperscript{117} Estate of Waitzman, 507 So. 2d 24, 25 (Miss. 1987).
\textsuperscript{118} Doerr v. Warner, 76 N.W.2d 505, 513 (Minn. 1956).
\textsuperscript{120} 326 U.S. 310 (1945).
\textsuperscript{121} \textit{Int'l Shoe}, 326 U.S. at 316.
\textsuperscript{122} 357 U.S. 235 (1958).
\textsuperscript{123} \textit{Hanson}, 357 U.S. at 256.
\textsuperscript{124} \textit{Id.} at 239.
\textsuperscript{125} \textit{Hanson v. Denckla}, 100 So. 2d 378, 385 (Fla. 1956).
\textsuperscript{126} Lewis v. Hanson, 128 A.2d 819, 834-35 (Del. 1957).
jurisdiction over the trustee or in rem jurisdiction over the trust corpus.\(^{127}\)

In its holding, the Court concluded that a probate proceeding in Florida could not give a Florida court in rem jurisdiction over out-of-state property so as to affect the rights of non-residents who were not already subject to the court’s personal jurisdiction.\(^{128}\) In addition, the Court held that Florida courts could not assert personal jurisdiction over an out-of-state trustee unless the trustee had “minimum contacts” with Florida.\(^{129}\) The minimum contacts in question had to include some act by which the trustee had purposefully availed itself of the privilege of conducting business in Florida.\(^{130}\) In this case, the Court observed:

The defendant trust company has no office in Florida, and transacts no business there. None of the trust assets have ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail.\(^{131}\)

The *Hanson* case continues to be followed,\(^{132}\) and under its reasoning, it would be difficult for an American court to assert personal jurisdiction over an offshore trustee as long as the trustee has not conducted business in the forum state.

Of course, a court may be able to assert in rem jurisdiction over the corpus of an out-of-state trust even though it cannot obtain personal jurisdiction over a foreign trustee. However, *Shaffer v. Heitner*\(^{133}\) suggests that this strategy may not always work. In *Shaffer*, a non-resident plaintiff invoked a Delaware statute to sequester stock and other securities owned by non-resident defendants but located in that state.\(^{134}\) The Delaware Supreme Court upheld the validity of the sequestration statute.\(^{135}\) On appeal, the United States Supreme Court held that the minimum contacts

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127. *Hanson*, 357 U.S. at 245. Florida law provided that the trustee in such a case was an indispensable party. *Id.*
128. *Id.* at 247-48.
129. *Id.* at 253.
130. *Id.*
131. *Id.* at 250-54.
standard was applicable to in rem jurisdiction. The Court declared that this standard could be readily satisfied in disputes over the ownership of property located in the forum state since a non-resident claimant would expect to benefit from that state's protection of his interest.

The Court also observed that in rem jurisdiction may also be appropriate when a plaintiff is injured on property located in the forum state but owned by a non-resident. However, the Court distinguished these cases from those where the property is completely unrelated to the plaintiff's cause of action. In this case, the property sequestered by the Delaware court was not the subject matter of the litigation, nor was the plaintiff's cause of action related to the property. The fact that the defendants served as officers and directors of a corporation chartered in Delaware did not provide sufficient contacts to give Delaware courts jurisdiction over them in a stockholders' derivative suit. In the absence of minimum contacts with Delaware, the state courts could not acquire jurisdiction over the defendants simply by attaching their property.

The difficulty of obtaining personal jurisdiction over a foreign trustee under International Shoe and Hanson is illustrated by Nastro v. D'Onofrio. In that case, Nastro, who had obtained a judgment against D'Onofrio in California, asked a federal district court in Connecticut to set aside the transfer of stock shares in certain Connecticut-based corporations as fraudulent transfers. Shortly after the California court held in favor of the defendant, he transferred the corporate stock to the Continental Trust Company, Ltd., on the Island of Jersey and established the Chana Trust for the benefit of his wife and children. The defendant argued that the lawsuit should be dismissed because the court had not acquired personal jurisdiction over Continental Trust, which the defendant claimed was an indispensable party under Rule 19 of the Federal Rules of Civil Procedure. The court acknowl-

136. Shaffer, 433 U.S. at 207.
137. Id. at 207-08.
138. Id. at 208.
139. Id. at 208-09.
140. Id. at 213.
142. Id. at 216-17.
143. 263 F. Supp. 2d 446 (D. Conn. 2003).
144. Nastro, 263 F. Supp. 2d at 448-49.
145. Id. at 449.
146. Id.
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Analyzed that Continental Trust was a “necessary” party as that term is used in Rule 19(a). As the court pointed out, in an action to set aside a fraudulent conveyance, the transferee of the property in question is a necessary party because the action to set aside the transfer necessarily affects the transferee’s interest in that property. Having decided that Continental Trust was a necessary party, the court declared that it must have personal jurisdiction over the foreign trustee in order to validly issue an injunction against it. Consequently, the court needed to determine whether there was a substantial probability that it would find a basis for federal jurisdiction over Continental Trust before it could issue a preliminary injunction against it.

Applying the reasoning of Hanson, the court concluded that it could not exercise jurisdiction over stock certificates located in the Island of Jersey. Even though the companies were located in Connecticut, the stock certificates evidencing ownership were located in Jersey, thereby foreclosing an assertion of quasi in rem jurisdiction. Likewise, there was no basis under Hanson for the court to exercise personal jurisdiction over Continental Trust. The only connection between Continental and the state of Connecticut was D’Onofrio’s unilateral act of settling the trust in Jersey, and this was not enough to satisfy the minimum contacts standard. Nor was the fact that the trust corpus was composed of stock in Connecticut companies sufficient to establish personal jurisdiction. For these reasons, the court granted the defendant’s motion to dismiss Continental and the Chana Trust.

However, even though the court could not obtain jurisdiction over the foreign trustees, it effectively thwarted the settlor’s plan by ordering the Connecticut companies, which were subject to its jurisdiction, to issue new stock certificates in the creditor’s name.

Another court took a more favorable view of the jurisdiction issue in Beaubien v. Cambridge Consolidated, Ltd. In that case, the plaintiffs brought suit in a Florida court against Cambridge,
the trustee of a trust established in the Cayman Islands, and Dwaine Carr, a Florida attorney. The plaintiffs alleged that they were beneficiaries of the trust and sought an accounting from the trustee. The plaintiffs also claimed that some of the trust's assets had been held in a Florida bank account controlled by Carr and that these funds disappeared after the lawsuit was filed. The court agreed that Carr, as a Florida resident, was subject to its jurisdiction. Carr conceded that he was an officer of Cambridge and provided legal services for the company, but maintained that Cambridge had never done any business in Florida, had no office in Florida, and had no agency or presence in the state. Nevertheless, the court declared that there was a factual dispute over whether Carr was merely an attorney for Cambridge or whether he acted as an active manager or agent for Cambridge in Florida. Therefore, the court concluded that the complaint against Cambridge should not have been dismissed for lack of jurisdiction.

It seems clear that no domestic court could obtain personal jurisdiction over an offshore trustee as long as it did not conduct business in the forum state. The settlor of an offshore asset protection trust could also defeat a creditor's attempt to assert in rem jurisdiction by removing all tangible trust property from the forum state. Finally, a creditor will not benefit from obtaining personal jurisdiction over the settlor as long as the settlor has not retained control over the offshore trust. An important exception to this is when the settlor has filed for bankruptcy. As the discussion below will show, once a bankruptcy court has obtained personal jurisdiction over a settlor, it can force the settlor to repatriate trust property by declaring it to be part of the settlor's bankruptcy estate and by withholding a discharge from bankruptcy until the property is returned.

2. Choice of Law Issues

Assuming that a court has jurisdiction over either the trustee or the trust property, it must decide whether to apply the law of the

157. Beaubien, 652 So. 2d at 937.
158. Id.
159. Id.
160. Id. at 940.
161. Id.
162. Beaubien, 652 So. 2d at 940.
163. Race to the Bottom, supra note 82, at 1091.
forum state, the law of the trust situs, or the law of some other jurisdiction in order to determine what rights a domestic creditor has against the trust's assets. When the creditor claims that a transfer to an out-of-state trust is fraudulent, the forum state will usually apply its own law. However, the choice of law issue is less clear when the transfer is not fraudulent and the case turns on the enforceability of an offshore trust's spendthrift provisions.

Conflict of law principles in cases involving the validity or construction of an inter vivos trust are fairly well-settled. For trusts in land, these issues are usually determined according to the law of the trust situs. For trusts of moveable assets, the law designated by the settlor will normally apply. However, the forum court may disregard the settlor's wishes if it concludes that the foreign law violates the forum state's public policy. This principle is illustrated by In re Brooks. In the summer of 1990, Brooks transferred stock certificates of various Connecticut corporations to his wife, who immediately thereafter used them to fund irrevocable trusts in Jersey and Bermuda. Each trust named Brooks as the sole income beneficiary and also allowed the trustee to make discretionary distributions of principal to Brooks as well. The trusts contained spendthrift provisions and provided that the law of the trust situs would apply to the trust.

In late 1991, creditors filed an involuntary chapter 7 petition for bankruptcy against Brooks, later converted to a voluntary proceeding under chapter 11. The bankruptcy trustee sought a ruling from the court that the assets in the two offshore trusts were part of the debtor's bankruptcy estate because they were self-settled and, therefore, ineffective against creditors. Brooks, on the other hand, contended that the trusts were not self-settled

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164. Restatement (Second) of Conflict of Law § 249(2)(b) (1971).
166. Restatement (Second) of Conflict of Laws § 268(1); Hutchinson v. Ross, 187 N.E. 65 (N.Y. 1933).
170. Id.
171. Id.
172. Id.
173. Id. at 100.
because they were established by his wife, and, therefore, the spendthrift provisions were effective against creditors.\textsuperscript{174}

The court declared that because a federal court must apply the choice of law rules of the forum state in which it sits, Connecticut choice of law rules would control.\textsuperscript{175} The court acknowledged that Connecticut courts usually respect the settlor’s intent as to what law is applicable to a trust, but observed that “the legality of trust personalty [is determined] by the law of the settlor’s domicile.”\textsuperscript{176} In addition, the court observed that Connecticut courts would not enforce the law of another jurisdiction which contravened the public policy of the state.\textsuperscript{177} Applying these criteria, the court ruled that the enforceability of the trusts’ spendthrift provisions would be determined under Connecticut law and not the law of Bermuda or Jersey.\textsuperscript{178} Not surprisingly, the court concluded that the trusts were self-settled, even though the debtor’s wife was the settlor, because the debtor actually provided the funds that were transferred from his wife to the trusts.\textsuperscript{179} Furthermore, the court held that under Connecticut law, the spendthrift provisions would not bar creditors’ claims.\textsuperscript{180} Consequently, the court ruled that property in the offshore trusts would be treated as part of the debtor’s bankruptcy estate.\textsuperscript{181}

Occasionally, choice of law analysis involves a two-step process. First, the court must determine whether to apply the choice of law rules of the forum state or some other jurisdiction. Having decided which choice of law rules control, the court must then analyze them to determine which jurisdiction’s \textit{substantive} law is applicable. This two-step process was utilized by a bankruptcy court in \textit{Portnoy v. Marine Midland Bank}.\textsuperscript{182} In that case, the court was required to decide whether to apply New York law or that of the Island of Jersey to determine what interest, if any, the debtor retained in an offshore trust.\textsuperscript{183} Portnoy, the sole shareholder and president of Mary Drawers, Inc., had agreed to assume personal liability for any loans Marine Midland Bank made to the com-
pany. Relying on this guarantee, Midland Marine loaned Mary Drawers more than $1 million in 1988. Late in 1989, Mary Drawers defaulted on the loan, and in 1991 the company declared bankruptcy. In 1990, Midland Marine sued Portnoy on his guarantee, and in 1995 Portnoy declared bankruptcy. Midland Marine argued that Portnoy should be denied a discharge in bankruptcy under sections 727(a)(2)(A) and 727(a)(4) of the Bankruptcy Code because he had deliberately concealed his assets by failing to disclose the existence of the offshore trusts.

Midland Marine relied on the "continuous concealment" doctrine to oppose Portnoy's discharge. Under this theory, a bankruptcy court can find that a concealment existed within a year of bankruptcy even if the initial concealment took place more than a year before bankruptcy, provided the debtor allowed the property to remain concealed into the critical year. Since Portnoy transferred the property to the offshore trust in 1989 but did not file for bankruptcy until 1995, if Portnoy effectively divested himself of any interest in the transferred property more than one year before declaring bankruptcy, section 727(a)(2)(A) would not apply.

As the court pointed out, "local law" would determine whether Portnoy retained an interest in the offshore trust. The question was whether the applicable local law was that of New York or that of the Island of Jersey, where the trust was located. First, the court considered whether to apply federal choice of law principles or those of the forum state, New York. As it turned out, under both federal common law and that of New York, the court was directed to apply the substantive law of the jurisdiction having the greatest interest in the litigation. Portnoy argued that the law of the Island of Jersey should determine whether he had any interest in the trust because Jersey was the situs of the trust, the trust instrument called for Jersey law to be applied, and the trustee was a Jersey resident. On the other hand, both Portnoy and

184. Id. at 688-89.
185. Id. at 689.
186. Id. at 690-91.
187. Id. at 691.
189. Id. at 695.
190. Id. (citing Rosen v. Bezner, 996 F.2d 1527, 1531 (3d Cir. 1993)).
191. Id. at 696.
192. Id.
193. Portnoy, 201 B.R. at 697.
194. Id.
195. Id. at 698.
his creditors resided in the United States and it was reasonable to expect that American, not foreign, law would govern. The court decided that New York had a greater interest than Jersey in determining whether Portnoy had retained and concealed a property interest in the trust.\footnote{196} The court decided that New York had a greater interest than Jersey in determining whether Portnoy had retained and concealed a property interest in the trust.\footnote{197}

Applying New York law, the court concluded that Portnoy had a property interest in the offshore trust.\footnote{198} The court went on to hold that giving effect to a self-settled spendthrift trust would offend New York law even though the trust was valid in Jersey.\footnote{199}

Accordingly, the court concluded that the trust assets were part of the bankruptcy estate and refused to grant a discharge to Portnoy until it could determine whether he intended to "hinder, delay, or defraud" his creditors when he transferred property to the Jersey trust and whether that intent continued into the one-year prepetition period.\footnote{200}

As Brooks and Portnoy illustrate, the strongly held bias against self-settled spendthrift trusts has led a number of American courts to apply choice of law rules in a way that eliminates any realistic chance that offshore asset protection trusts will be recognized domestically, regardless of whether they are valid in the jurisdiction where they were created.

C. Protective Devices

As discussed earlier, offshore asset protection trust instruments usually contain a number of provisions that are designed to prevent creditors from enforcing judgments obtained in American courts against a foreign trustee. These include provisions for the appointment of trust protectors, anti-duress clauses, and flight clauses. As one might expect, American courts have generally done their best to undermine the effectiveness of these devices.

1. Trust Protectors

A trust protector is someone who is appointed by the settlor to act as an advisor to the trustee and to ensure that the trustee carries out the settlor's wishes.\footnote{201} However, the use of a trust protec-

\footnote{196. Id.}
\footnote{197. Id.}
\footnote{198. Portnoy, 201 B.R. at 699.}
\footnote{199. Id. at 699-701.}
\footnote{200. Id. at 701.}
\footnote{201. Trust Protectors, supra note 34, at 2764.}
tor device has sometimes backfired and enabled courts to impute control over the trust to the settlor when he has named himself or a family member as trust protector.\textsuperscript{202}

For example, in \textit{Federal Trade Commission v. Affordable Media, LLC}, the court concluded that the settlors had retained control of their offshore trust because they made themselves trust protectors.\textsuperscript{203} In 1995, Michael and Denyse Anderson established an irrevocable trust in the Cook Islands, naming themselves as trustees along with AsiaCiti Trust Limited, a company that was licensed to provide trust services in the Cook Islands.\textsuperscript{204} For good measure, the Andersons also named themselves as protectors of the trust.\textsuperscript{205} As trust protectors, the Andersons had the power to appoint new trustees and to make the final decision as to when the trust’s anti-duress clause should be invoked.\textsuperscript{206} In 1997, the Andersons formed a telemarketing company, Financial Growth Consultants, to sell “media units” to the public.\textsuperscript{207} In fact, the Anderson’s marketing operation was found to be an elaborate Ponzi scheme that defrauded thousands of investors.\textsuperscript{208} The Andersons received an estimated $6.3 million in sales commissions while those who purchased media units from them lost their investments.\textsuperscript{209}

In 1998, the Federal Trade Commission (FTC) charged the Andersons with participating in a scheme to market fraudulent investments to consumers.\textsuperscript{210} At the request of the FTC, a federal district court in Nevada issued a restraining order, followed by a preliminary injunction, requiring the Andersons to repatriate any assets held for their benefit outside of the United States.\textsuperscript{211} In response to the restraining order, the Andersons sent a letter to AsiaCiti in the Cook Islands, instructing the trustee to provide an accounting of the trust and to repatriate the trust’s assets to the United States.\textsuperscript{212} Not surprisingly, AsiaCiti concluded that the

\textsuperscript{203} Affordable Media, 179 F.3d at 1228.
\textsuperscript{204} Id. at 1232.
\textsuperscript{205} Id.
\textsuperscript{206} Id. at 1242.
\textsuperscript{207} Id. at 1231.
\textsuperscript{208} Race to the Bottom, supra note 82, at 1101.
\textsuperscript{209} Affordable Media, 179 F.3d at 1232.
\textsuperscript{210} Id.
\textsuperscript{211} Id.
\textsuperscript{212} Id. at 1232.
court order was an “event of duress” which authorized it to remove the Andersons as co-trustees, refuse to repatriate the trust’s assets and refuse to provide an accounting.\textsuperscript{213} The Andersons maintained that once they were removed as trustees, they could not compel AsiaCiti to comply with the injunction.\textsuperscript{214} However, the district court refused to believe the Andersons and imprisoned them for civil contempt.\textsuperscript{215} On appeal, the Ninth Circuit Court of Appeals upheld the lower court’s ruling.\textsuperscript{216}

Rejecting the Andersons’ impossibility claim, the appeals court focused on their status as trust protectors. The court pointed out that the trust enabled the protectors to appoint new trustees and also gave them the power to conclusively determine whether an event of duress had occurred.\textsuperscript{217} According to the court, the Andersons could have overruled AsiaCiti’s determination that the preliminary injunction constituted an event of duress, and they also could have directed the trustee to repatriate the trust’s assets to the United States.\textsuperscript{218} As the court observed, the Andersons were no doubt aware of this power because shortly after the restraining order was issued, they made a belated attempt to resign as trust protectors.\textsuperscript{219} While their appeal was pending, the district court released the Andersons from custody, but ruled that they remained in contempt of court.\textsuperscript{220} Following the appeal, the FTC brought an action against AsiaCiti in the Cook Islands.\textsuperscript{221} The parties ultimately settled, and AsiaCiti transferred $1.2 million from the Andersons’ trust to the FTC.\textsuperscript{222}

As the Andersons discovered, the trust protector device can be a double-edged sword. If the settlor is also the trust protector, an American court can order him to direct the foreign trustee to repatriate the trust’s assets.\textsuperscript{223} This could also occur if a trust protector, such as a friend or relative of the settlor, is subject to the court’s jurisdiction. To protect against such actions by American courts, the trust protector’s powers should be formulated as negative powers, that is, the power to veto acts or decisions of the for-

\begin{itemize}
  \item 213. \textit{Id}.
  \item 214. \textit{Affordable Media}, 179 F.3d at 1230.
  \item 215. \textit{Id}. at 1233.
  \item 216. \textit{Id}. at 1244.
  \item 217. \textit{Id}. at 1242.
  \item 218. \textit{Id}. at 1243 n.13.
  \item 219. \textit{Affordable Media}, 179 F.3d at 1243.
  \item 220. \textit{Id}. at 1233.
  \item 221. \textit{Professional Responsibility, supra} note 41, at 587.
  \item 222. \textit{Id}.
  \item 223. \textit{Trust Protectors, supra} note 34, at 2764.
\end{itemize}
eign trustee, and not affirmative powers, such as the right to appoint new trustees or transfer the trust's assets. 224

2. Anti-Duress Clauses

An anti-duress clause prohibits a foreign trustee from complying with any order imposed upon the settlor, a domestic trustee or the foreign trustee by an American court. 225 As one might expect, American courts do not take kindly to anti-duress clauses. For example, in Lawrence v. Goldberg, 226 a bankruptcy court determined that the corpus of an offshore trust located in Mauritius was part of the debtor's bankruptcy estate and ordered him to turn over the trust property to the bankruptcy trustee. 227 Later, a federal appeals court upheld the district court's finding that the anti-duress clause was void as to current and future creditors under Florida law because it was part of an invalid self-settled spendthrift trust. 228 The court stated that the sole purpose of the anti-duress clause was to enable Lawrence to evade liability for contempt while merely feigning compliance with the court's order. 229 The court further declared that the validation of such a clause in these circumstances "would contravene public policy proscribing a debtor from shielding money placed in Trust for his or her own benefit and to the prejudice of legitimate creditors." 230

In Affordable Media, a temporary restraining order issued against the Andersons induced their Cook Island trustee to invoke the trust's anti-duress clause and remove them as co-trustees. 231 This action removed the Andersons as trustees, thereby leaving AsiaCiti in sole control over the trust as the remaining trustee. Nevertheless, the court concluded that the Andersons still retained the ability to repatriate the trust's assets to the United States through the exercise of their powers as trust protectors. 232

Although the anti-duress clause is a potentially useful tool, if the settlor reserves the power to overrule the trustee's decision to

224. Gideon Rothschild, Establishing and Drafting Offshore Asset Protection Trusts, 23 EST. PLAN. 65, 70 (1996); but see Trust Protectors, supra note 34, at 2765 (discussing the disadvantages of limiting the protector to negative powers).
225. Lorenzetti, supra note 28, at 146.
226. 279 F.3d 1294 (11th Cir. 2002).
227. Lawrence, 279 F.3d at 1297.
228. Id.
229. Id.
230. Id. at 1299.
231. Fed. Trade Comm'n v. Affordable Media, LLC, 179 F.3d 1228, 1232 (9th Cir. 1999).
232. Affordable Media, 170 F.3d at 1242.
invoke the anti-duress clause, an American court may order him to do so and hold him in contempt if he fails to comply with the court's order. To prevent this from happening, the trustee or the trust protector (who is not within the court's jurisdiction), not the settlor, must have the sole right to trigger the anti-duress clause.

3. Flight Clauses

Another common provision is a flight clause, which empowers the trustee to take whatever actions are necessary in order to protect the trust's assets against threats of nationalization, expropriation or political instability in the situs jurisdiction. A flight clause was involved in Securities and Exchange Commission v. Brennan. The settlor, Robert Brennan, owned and operated First Jersey Securities, Inc., a discount brokerage house that specialized in the underwriting, trading and distribution of low-priced securities. The SEC brought an action against Brennan, alleging that he had defrauded First Jersey customers by inducing them to buy securities at excessive prices. In 1995, a federal district court held in favor of the SEC and ordered Brennan and First Jersey to disgorge approximately $75 million in illegal profits. Almost immediately thereafter, Brennan filed for bankruptcy.

Sometime during the trial, Brennan established an offshore asset protection trust, named the Cardinal Trust, in Gibraltar and funded it with $5 million in municipal bonds. Brennan named his children and the Robert E. Brennan Foundation as trust beneficiaries; however, the trustee was not required to make any payments to these beneficiaries during the life of the trust. The trust was to terminate at the end of ten years, at which time the trust corpus would revert to Brennan. In response to the bankruptcy trustee's efforts to recover the assets of the Cardinal Trust, the trust changed its situs from Gibraltar to Mauritius and then

233. Danforth, supra note 51, at 310.
234. 230 F.3d 65 (2d Cir. 2000).
236. Id. at 67-68.
238. Brennan, 230 F.3d at 68.
239. Id.
240. Id.
241. Id.
from Mauritius to Nevis. These moves were prompted by the trust's flight clause, which required the trustee to relocate the trust upon the occurrence of government action in any part of the world that attempts to take control of the trust assets or "any order, decree or judgment of any court . . . which will or may . . . in any way control, restrict or prevent the free disposal" of trust property. Nevis proved to be a safe haven for Brennan; when the bankruptcy trustee brought suit to recover the trust's assets, the High Court of St. Kitts and Nevis dismissed the action. Brennan also won a temporary victory when the appeals court concluded that the lower court's repatriation order violated the automatic stay provisions of the Bankruptcy Code.

D. Remedial Powers

American courts have also made use of their remedial powers to circumvent the protection afforded to debtors by offshore asset protection trusts. For example, bankruptcy courts have refused to discharge debtors from bankruptcy, and other courts have invoked their civil contempt power to force debtors to repatriate property held in offshore trusts.

1. Withholding Discharge from Bankruptcy

Even when a bankruptcy court cannot obtain jurisdiction over a foreign trustee, it can put pressure on a settlor who has filed for bankruptcy. Thus, a bankruptcy court denied a discharge to a debtor in Colburn v. Peoples Bank of Charles Town. In Colburn, the debtor made seven false statements under oath relating to prior businesses, two bank accounts, transfers of stock and cattle, oil and gas interests, tax refunds, claims for unpaid salary, and sources of income during 1987 and 1988. He also failed to disclose his reversionary interest in a Bermuda trust. Applying the provisions of section 727(a)(4) to these facts, the court concluded that the debtor acted with fraudulent intent and denied him a discharge. The court also justified denial of a discharge
on the concealment provisions of section 727(a)(2), concluding that
the debtor's failure to disclose the existence of the Bermuda trust
was based on an intent to hinder or delay creditors. Finally, the
court found that a denial of discharge was justified by section
727(a)(3) for failure to keep or preserve records from which his
financial condition may be ascertained. When the trust was
discovered, Colburn claimed that he could not provide a copy of
the trust agreement, thereby making it impossible to determine
what control he had over the trust or what interest he had in the
trust's assets.

2. Civil Contempt

Some courts have even used their contempt power to circumvent
an offshore trust's protective devices. In Federal Trade Commis-
sion v. Affordable Media, LLC, the FTC sought to recover millions
of dollars that Michael and Denyse Anderson had transferred to a
trust in the Cook Islands. When the Andersons claimed that
they could not comply with a preliminary injunction requiring
them to repatriate the trust property, the district court held them
in civil contempt and ordered them to be incarcerated. On ap-
peal, the federal circuit court stated that the party seeking con-
tempt must show by clear and convincing evidence that the defen-
dants violated a specific and definite order of the court. Once
that burden was met, the defendants had to demonstrate why
they were unable to comply. However, the court added, in the
case of an asset protection trust, "the burden on the party asserting
an impossibility defense will be particularly high because of
the likelihood that any attempted compliance with the court's or-
ders will be merely a charade rather than a good faith effort to
comply." On the other hand, the Andersons contended that the trust's
anti-duress clause prevented them from complying with the
court's order. The clause provided that the Andersons would
automatically be removed as co-trustees if an event of duress oc-

250. Id. at 859 (citing 11 U.S.C. § 727(a)(2)).
251. Id. at 861 (citing 11 U.S.C. § 727(a)(3)).
253. 179 F.3d 1228, 1230 (9th Cir. 1999).
254. Affordable Media, 179 F.3d at 1233.
255. Id. at 1239.
256. Id.
257. Id. at 1241.
258. Id. at 1240.
However, the court ruled that the impossibility defense was not applicable because the Andersons could comply with the preliminary injunction, notwithstanding the duress clause, by exercising their powers as trust protectors. As the court pointed out, the Andersons could nullify the determination of the Cook Islands trustee that an event of duress had occurred and direct the trustee to repatriate the trust property to the United States. Consequently, the appeals court affirmed the lower court’s ruling that the Andersons’ failure to comply with the preliminary injunction constituted contempt of court.

Another court used its contempt power to coerce a settlor to return the corpus of an offshore trust in Securities and Exchange Commission v. Bilzerian. In Bilzerian, the defendant was convicted of engaging in securities fraud and ordered to disgorge $62 million in illegal profits and accrued interest. Instead, Bilzerian transferred much of his property to an asset protection trust that he had established in the Cook Islands. When Bilzerian claimed that he was unable to provide copies of the trust instruments or other financial documents, the court held him in civil contempt. Further, the court rejected Bilzerian’s claim that he could not compel the Cook Islands trustee to comply with the court’s order.

Bilzerian also argued that the automatic stay provision of the Bankruptcy Code prevented the district court from enforcing its contempt order. This provision provides that almost all proceedings against a debtor are stayed upon his declaration of bankruptcy. The court, however, declared that the contempt proceeding was not subject to the automatic stay provision because two exceptions were applicable: (1) the exception for a governmental unit to exercise its police powers and (2) the exception to uphold the dignity of the court and vindicate the court’s authority to enforce its orders.

259. Affordable Media, 179 F.3d at 1240.
260. Id. at 1242.
261. Id. at 1243.
262. Id. at 1243-44.
265. Id. at 16.
266. Id. at 16-18.
267. Id. at 16.
268. Id. at 14.
The first exception was applicable because the court’s order merely required the debtor to provide an accounting of his assets in order to purge himself of contempt and did not constitute a money judgment against him.\textsuperscript{271} The court also found that the second exception was applicable because the purpose of the contempt proceeding was to vindicate the integrity of the court.\textsuperscript{272} The court observed that the defendant had violated two direct orders of the court and had not complied with the court’s temporary purgation requirements.\textsuperscript{273} In the court’s view, it had the inherent power to ensure that Bilzerian complied with its orders.\textsuperscript{274} Therefore, the court concluded that the automatic stay provision was not applicable and ordered Bilzerian’s incarceration until he provided the required information about the Cook Islands trust.\textsuperscript{275}

A final example of the use of civil contempt against a recalcitrant settlor is \textit{Goldberg v. Lawrence}.\textsuperscript{276} Prior to October 19, 1987, known in the securities industry as “Black Monday,” the defendant, Lawrence, had been a successful options trader who used Bear, Stearns & Co. (“Bear Stearns”) as his trading clearinghouse.\textsuperscript{277} Following the stock market crash, Bear Stearns attempted to force Lawrence to pay the deficit in his margin account.\textsuperscript{278} In 1991, an arbitrator awarded Bear Stearns more than $20 million against Lawrence and some of his trading companies.\textsuperscript{279} During the arbitration, Lawrence established a trust in the Jersey Channel Islands.\textsuperscript{280} A month later, he amended the trust to provide that it would be governed by the law of Mauritius.\textsuperscript{281} Lawrence filed for bankruptcy in June, 1997.\textsuperscript{282} In 1999, the bankruptcy trustee obtained an order directing Lawrence to turn over the assets of the offshore trust.\textsuperscript{283} When Lawrence failed to comply with the court’s order, he was held in contempt and incarcerated.\textsuperscript{284}

\textsuperscript{271.} Id.  
\textsuperscript{272.} Id. at 15.  
\textsuperscript{273.} Id.  
\textsuperscript{274.} Id.  
\textsuperscript{275.} \textit{Bilzerian}, 131 F. Supp. 2d at 18.  
\textsuperscript{276.} 227 B.R. 907, 911 (Bankr. S.D. Fla. 1998).  
\textsuperscript{277.} \textit{Goldberg}, 227 B.R. at 911.  
\textsuperscript{278.} Id.  
\textsuperscript{279.} Id. at 911-12.  
\textsuperscript{280.} Id. at 910.  
\textsuperscript{281.} Id.  
\textsuperscript{282.} \textit{In re Lawrence}, 279 F.3d 1294, 1297 (11th Cir. 2002).  
\textsuperscript{283.} \textit{Lawrence}, 279 F.3d at 1297.  
\textsuperscript{284.} Id.
The federal appeals court confirmed that the bankruptcy court had the power to imprison Lawrence for contempt of court when he failed to comply with a Turn Over Order.285 The court declared that once a proper showing of a violation of the order was made, the burden of production shifted to the defendant, who must go beyond a mere assertion of inability and establish that he has made, in good faith, all reasonable efforts to meet the terms of the court order.286 The court then reviewed the terms of the trust, which according to Lawrence made it impossible for him to force the foreign trustee to turn over the trust's assets to the bankruptcy trustee. Although Lawrence, in his capacity as settlor, could appoint or remove trustees, the trust, as amended, contained an anti-duress clause that provided that this power could not be exercised under duress or coercion.287

Lawrence contended that he had tried to remove the Mauritian trustee and appoint the bankruptcy trustee as trustee of the offshore trust, but the Mauritian trustee had apparently invoked the anti-duress clause and ignored Lawrence's order.288 In any event, the court held that Lawrence's last-minute appointment of the bankruptcy trustee fell short of the requirement that he make "in good faith all reasonable efforts" to comply with the court's order.289 In the court's view, Lawrence knew that the Mauritian trustee would ignore his request.290 The court also made it clear that it believed that Lawrence continued to maintain control over the trust despite the fact that he had apparently divested himself of any beneficial interest in it.291

Finally, the appeals court declared that Lawrence could not raise an impossibility defense because the impossibility, if one ex-

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285. Id. (citing In re Hardy, 97 F.3d 1384 (11th Cir. 1996)). A “turn over order” is an order issued by a bankruptcy court which directs the debtor, or one who controls property, to turn over property that is part of the bankruptcy estate to the bankruptcy trustee. This procedure is authorized by section 542(a) of the Bankruptcy Code, which declares that:
(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

286. Lawrence, 279 F.3d at 1297.
287. Id. at 1296.
288. Id. at 1299-1300.
289. Id. at 1300.
290. Id.
291. Lawrence, 279 F.3d at 1299.
isted, was entirely self-created. Lawrence argued that the self-created impossibility exception only applied to conditions that arose after the commencement of the legal action, and in his case, the trust provisions were implemented several years prior to the filing of his bankruptcy petition. However, the court rejected this reasoning, declaring that Lawrence had set up the offshore trust in anticipation of an expected adverse arbitration award against him by Bear Stearns.

The contempt power is an effective weapon to use against settlors. The only way for settlors to avoid the risk of being held in contempt is to divest themselves of any formal control over the trust before any creditor's claims have been made and to put their "trust" in the good faith of the foreign trustee. Even then, some courts may refuse to recognize an impossibility defense when the impossibility is self-created.

3. Other Remedies

In Nastro v. D'Onofrio, the defendant transferred ownership of his shares in several Connecticut-based companies to an asset protection trust located in the Island of Jersey. Nastro, a creditor, asked a federal district court to set aside the transfer so that he could enforce a California judgment against the defendant by levying against the shares. Nastro also requested the court to issue a preliminary injunction against the foreign trustee. The court, however, ruled that Connecticut's long-arm statute would not confer personal jurisdiction over the trustee or quasi-in rem jurisdiction over stock certificates located in Jersey.

Fortunately for Nastro, the court also concluded that it did have the power to order a Connecticut corporation to delete the trustee as owner of the stock in the corporate ledger and issue new stock certificates in the name of Nastro. The court also declared that the "[c]ourts have a responsibility to remedy wrongful conduct, and have, recently, cast a discerning eye at the substantiality of

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292. Id. at 1300 (citing Pesaplastic, C.A. v. Cincinnati Milacron Co., 799 F.2d 1510, 1521 (11th Cir. 1986)).
293. Id.
294. Id.
297. Id. at 449.
298. Id. at 450.
299. Id. at 453.
300. Id. at 455.
off-shore spendthrift trusts in order to find the proverbial 'chink in the armor.'” 301 Finally, the court observed that this remedy would not be unfair to the parties because either the trustee or the trust beneficiaries would have standing to contest the action and assert any defenses they might have to the creditor's fraudulent transfer claim. 302 In effect, the court overcame its lack of jurisdiction by forcing the offshore trustee to submit to its jurisdiction if it wanted to preserve the trust's beneficial interest in the Connecticut-based companies' stock.

III. A PROPOSED RULE FOR OFFSHORE ASSET PROTECTION TRUSTS

A. Judicial Hostility to Offshore Asset Protection Trusts

In general, American courts have taken a dim view of offshore protection trusts. For example, in Affordable Media, the court declared that “[t]he ‘asset protection’ aspect of these foreign trusts arises from the ability of people, such as the Andersons, to frustrate and impede the United States courts by moving their assets beyond those courts' jurisdictions.” 303 The court went on to suggest that, given the nature of asset protection trusts, it would be reluctant to accept an impossibility defense to a contempt charge. According to the court, “[g]iven that these offshore trusts operate by means of frustrating domestic courts' jurisdiction, we are unsure that we would find that the Andersons' inability to comply with the district court's order is a defense to a civil contempt charge.” 304

A federal appeals court took a similar approach when it refused to recognize the effectiveness of an anti-duress clause. 305 The court observed that “[t]he sole purpose of this provision appears to be an aid to the settlor to evade contempt while merely feigning compliance with the court’s order” and further stated that “the validation of such a provision would contravene public policy proscribing a debtor from shielding money placed in a Trust for his or her own benefit and to the prejudice of legitimate creditors.” 306

Another court declared that “[w]hile such trusts may have benefits in asset protection, the use of such trusts to avoid alimony,
child support, and a fair division of marital property upon divorce is reprehensible to us."\textsuperscript{307}

Although many of the settlors involved in these cases had engaged in fraudulent transfers or worse, the hostility of American courts to offshore protection trusts seems to be based more on the concept of asset protection, at least in this form, than it does on the bad faith of debtors. I believe that this hostility is unjustified. Many of the arguments traditionally made against self-settled spendthrift trusts, both domestic and foreign, are weak and inconsistent. In addition, American courts have generally overlooked the useful social purposes that asset protection trusts can serve.

\textbf{B. Arguments for Not Recognizing Self-Settled Spendthrift Trusts}

American courts have consistently refused to protect property in offshore asset protection trusts against the claims of domestic creditors. The principal reason for this is they believe that these offshore trusts are nothing more than a form of self-settled spendthrift trust. The rule in most American states is that debtors cannot insulate themselves from the claims of creditors by placing their property in domestic self-settled spendthrift trusts.\textsuperscript{308} Therefore, before deciding how to treat offshore trusts, it may be useful to consider why American courts look with disfavor upon attempts by settlors to establish domestic spendthrift trusts.

One justification for the rule against self-settled spendthrift trusts is the notion that "[y]ou should keep your promises and pay your debts because it is the right thing to do."\textsuperscript{309} Of course, this begs the question of \textit{why} it is right to keep one's promises and pay one's debts. One basis for this obligation is consent. One who has voluntarily assumed contractual obligations should not be able to avoid fulfilling these obligations by hiding behind a self-created legal barrier. On the other hand, this rationale does not seem to apply to "involuntary" creditors, such as alimony and child support claimants or tort victims. Perhaps one can argue that marriage and parenthood are "voluntary" relationships, at least in the beginning, and that one who marries or becomes a parent impliedly consents to assume the burdens and obligations associated with such relationships. However, even if that is so, the consent

\begin{itemize}
\item \textsuperscript{307} Breitenstine v. Breitenstine, 62 P.2d 587, 593 (Wyo. 2003).
\item \textsuperscript{308} Sjuggerud, \textit{supra} note 4, at 979.
\item \textsuperscript{309} Boxx, \textit{supra} note 3, at 1259.
\end{itemize}
rationale provides little support for tort creditors who wish to reach assets that have been placed in a self-settled spendthrift trust.

At first blush, corrective justice seems to be a better rationale than consent for rejecting self-settled spendthrift trusts. Corrective justice is concerned with rectifying wrongful gains and losses. This rationale is fairly strong where the claimants are victims of theft and fraud. In such cases, where the defendant has been unjustly enriched at the expense of the plaintiff, principles of corrective justice support the return of property to the plaintiff that the defendant has obtained fraudulently or illegally. The corrective justice argument, however, does not seem very compelling in the case of alimony or child support claims because the claimants are not seeking the return of property that the defendant has wrongfully taken from them. This rationale does not provide much support for tort victims either, particularly when the defendant has not obtained an economic benefit at their expense.

A second justification for the rule is that self-settled spendthrift trusts are inherently fraudulent. According to commentator George Bogert, if self-settled spendthrift trusts were enforceable it would:

> give unexampled opportunity to unscrupulous persons to shelter their property before engaging in speculative business enterprises, to mislead creditors into thinking that the settlor still owned the property since he appeared to be receiving its income, and thereby work a gross fraud on creditors who might place reliance on the former prosperity and financial stability of the debtor.

However, this “fraud on creditors” rationale is incomplete because it does not apply to involuntary creditors who take their debtors as they find them. More importantly, the risk of fraud seems overrated. Prudent creditors can avoid deadbeats by investigating the finances of prospective debtors more carefully, and fraudulent transfer statutes offer additional protection against fraud.

The final justification for the rule against enforcement of self-settled spendthrift trusts is that they undermine the deterrent

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312. Wagenfeld, supra note 29, at 843.
313. Boxx, supra note 3, at 1255.
effect of civil liability. According to Professor Lynn Lopucki, governments enforce legal rules by criminal sanctions and civil liability.\textsuperscript{314} Speaking of the civil liability system, Professor Lopucki has declared:

The liability system enforces liability through the entry and forcible collection of judgments for the payment of money. Although liability is most closely associated with products liability and other tort actions, money judgments are also the means of enforcing contracts, civil rights, labor and employment law, environmental regulations, federal tax law, intellectual property law, most kinds of property rights, and just about every other kind of law on the books.\textsuperscript{315}

However, Professor Lopucki believes that the existing system by which money judgments are enforced is beginning to fail as more and more potential defendants are developing ways to make themselves judgment proof, thereby achieving immunity from the deterrent aspects of the civil liability system.\textsuperscript{316} If individuals can protect against civil liability by transferring their property to a spendthrift trust, a “moral hazard” situation will be created because these individuals can engage in unreasonably risky behavior without having to worry about personal liability for the harm that they cause.\textsuperscript{317}

Although there is merit to Professor Lopucki’s argument, I would emphasize that self-settled spendthrift trusts, foreign or domestic, are but one way to make oneself judgment proof against creditors. As Professor Lopucki has pointed out, there are many devices available to business entities to insulate themselves against liability.\textsuperscript{318} Individuals can also employ a variety of strategies to limit their liability.\textsuperscript{319} Consequently, it seems inconsistent to single out self-settled asset trusts for condemnation while permitting businesses and individuals to avoid liability in so many other ways.

\textsuperscript{315} Id. at 4.
\textsuperscript{316} Id.
\textsuperscript{317} Danforth, supra note 51, at 364.
\textsuperscript{318} Lopucki, supra note 314, at 14-38.
\textsuperscript{319} Giles, supra note 1, at 623-61.
C. Arguments for Recognizing Self-Settled Spendthrift Trusts

There are a number of reasons why American courts should relax their opposition to self-settled spendthrift protection trusts. First, the traditional rule against self-settled trusts is not universally accepted. According to one commentator, "America stands virtually alone in its rigid and virtually absolute adherence to the rule against self-settled trusts." Great Britain has long recognized a form of self-settled spendthrift trust known as a protective trust. A large number of present and former British possessions have enacted legislation authorizing self-settled trusts. Even in the United States, at least eight states have now rejected the majority view and allow self-settled spendthrift trusts to be created in their territory. This suggests that there is no consensus about the legitimacy of self-settled spendthrift trusts and, therefore, American courts should respect the choices that other countries make even though they differ from domestic policy preferences.

Furthermore, virtually all jurisdictions in the United States allow individuals to secure protection from creditors by utilizing such protective devices as homestead property, tenancies by the entirety, retirement plans, family limited partnerships, limited liability companies, life insurance policies, and annuity contracts. To be sure, many of these devices provide only limited protection against the claims of creditors, but the fact that they exist with state approval suggests that asset protection strategies are not necessarily contrary to public policy even though they reduce the ability of creditors to obtain payment from their debtors. Thus, the traditional rule against self-settled trusts is inconsistent with these state policies that protect debtors.

Another argument is that a broad rule against self-settled spendthrift trusts gives creditors more rights than settlors when a trust is self-settled. For example, when the self-settled trust is a support trust or a discretionary trust, the settlor cannot compel the trustee to distribute funds from the trust. However, under the traditional rule, a court will compel the trustee to distribute for

320. Sullivan, supra note 19, at 433.
321. See supra, note 27 and accompanying text.
323. Danforth, supra note 51, at 333-47.
324. Boxx, supra note 3, at 1256.
325. Nenno, supra note 79, at 274.
the creditor's benefit the maximum amount that the trustee could have distributed to the settlor.\textsuperscript{326} There is no theoretical or practical justification for this asymmetrical treatment of settlor and creditor. As Professor Danforth pointed out, the apparent rationale for this approach is the assumption that the settlor will always control the exercise of trustee discretion when it comes to distributions from the trust.\textsuperscript{327} However, there is no proof that this assumption is generally correct, and such conduct, if it did occur, would be inconsistent with the trustee's fiduciary duty of impartiality. Furthermore, the traditional approach also fails to protect the interests of other beneficiaries. By allowing a creditor of the settlor to reach the maximum amount that the trustee could distribute to him, the traditional rule ignores the fact that other beneficiaries might be able to challenge such a distribution on grounds that the trustee violated its duty of impartiality. In other words, the traditional rule allows creditors to reach trust assets that might have been distributed to other beneficiaries.\textsuperscript{328}

Legal scholars also point out that the traditional rule against self-settled trusts favors inherited wealth over earned wealth.\textsuperscript{329} Most states allow a wealthy settlor to create a spendthrift trust for the benefit of another, typically a child or grandchild, and thereby preserve the family's wealth from the younger generation's creditors. On the other hand, individuals who acquire wealth by their own efforts enjoy no such advantage under the traditional rule.\textsuperscript{330} Allowing self-settled spendthrift trusts would remove this disparity and allow persons who acquire wealth to obtain the same protection as those who inherit it.\textsuperscript{331}

Moreover, there are affirmative reasons to recognize self-settled spendthrift trusts. First of all, they enable professionals and small business owners to engage in socially beneficial activities without fear of being wiped out by massive civil liability. While large-scale business enterprises can insulate themselves from excessive liability,\textsuperscript{332} individuals like physicians, lawyers, stockbrokers, financial planners, architects, farmers, and small business

\textsuperscript{326} Greenwich Trust Co. v. Tyson, 27 A.2d 166, 173 (Conn. 1942); Ware v. Gulda, 117 N.E.2d 136, 137 (Mass. 1954); \textit{In re Hortsberg Inter Vivos Trust}, 578 N.W.2d 289, 291 (Mich. 1998).

\textsuperscript{327} Danforth, \textit{supra} note 51, at 302-03.

\textsuperscript{328} \textit{Id.} at 359-60.

\textsuperscript{329} Note, \textit{A Rationale for the Spendthrift Trust}, 64 COLUM. L. REV. 1323, 1332 (1964).

\textsuperscript{330} Boxx, \textit{supra} note 3, at 1254-55.

\textsuperscript{331} Danforth, \textit{supra} note 51, at 361.

\textsuperscript{332} Lopucki, \textit{supra} note 314, at 14-38.
owners are not so fortunate. According to one commentator, these people feel that “[e]xpanding theories of legal liability, result-oriented judges, juries willing to disregard precedent, unpredictably high damage awards, and the unavailability of adequate insurance coverage” have greatly increased their liability exposure.\(^{333}\) The increasing willingness of juries to make large punitive damage awards has also adversely affected the liability equation. The prospect of exposure to changing liability rules and excessive damage awards arguably deters people from engaging in socially useful, but risky, activities.\(^{334}\) The protection provided by self-settled spendthrift trusts may offset some of the undesirable effects of modern tort law.\(^{335}\)

Self-settled spendthrift trusts also provide some protection against fraudulent or frivolous lawsuits.\(^{336}\) Unfortunately, our society has become increasingly litigious. Because few cases go to trial and settlement is the norm, plaintiffs and their lawyers are encouraged to bring meritless or even fraudulent lawsuits in the hopes of receiving a generous settlement from defendants who are concerned about the costs of litigation or the bad publicity associated with it. Defendants whose property is protected by a spendthrift trust are less inviting targets for such “nuisance” suits. Some commentators have contended that the immunity from civil liability offered by self-settled spendthrift trusts may reduce the incentive to exercise due care or to purchase adequate liability insurance.\(^{337}\) They also maintain that if the tort system is out of control, the proper response is to correct its abuses rather than provide tortfeasors with immunity from liability.\(^{338}\) However, the record shows that thirty years of effort to reform tort law has yielded little, and there is no reason to think that future efforts will be any more successful. For individuals whose life savings are currently threatened by civil liability, self-settled spendthrift trusts may be a legitimate way to deal with this problem.

In the foregoing discussion, I have attempted to show that the concept of the self-settled spendthrift trust is not inherently bad.

\(^{333}\) Wagenfeld, supra note 29, at 836-37.


\(^{335}\) Brown, supra note 5, at 139.

\(^{336}\) Rothschild, supra note 224, at 65-66.

\(^{337}\) Karen Gebbia-Pinetti, As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law, in SC60 Advanced Estate Planning Techniques 179, 213 (ALI-ABA 1998); Wagenfeld, supra note 29, at 843.

\(^{338}\) Boxx, supra note 3, at 1261.
Offshore asset protection trusts are nothing more than self-settled spendthrift trusts (with a few extra protective features) that are located in a foreign jurisdiction instead of in the United States. Given the popularity of offshore sites as a place for businesses and individuals to conduct financial transactions, it would be difficult to argue that a self-settled spendthrift trust would be undesirable simply because it is located in a foreign country instead of in the United States. Consequently, if one can make a case for a domestic self-spendthrift trust, as I have attempted to do above, the same case can be made on behalf of foreign asset protection trusts. Of course, both domestic self-settled trusts and foreign asset protection trusts come in many forms. Therefore, even if we agree to accept the concept of a self-settled trust, some trusts may raise policy concerns. For this reason, in the section below I will describe the type of trust that should be recognized by American courts.

D. A Proposed Approach to Offshore Asset Protection Trusts

1. Implementation

A basic problem with any rule regarding offshore asset protection trusts is implementation. Because other countries are involved, the preferred mechanism for implementation would be a bilateral or multilateral treaty. The United States government could enter into treaties with the countries that authorize asset protection trusts. A treaty with Great Britain may be necessary to cover British possessions like Bermuda or the Cayman Islands, which are not independent. Such a treaty would provide that American courts would recognize the validity of offshore trusts that meet the requirements outlined below in subsection 3. A more restrictive alternative would apply only to federal bankruptcy courts, thus leaving the states free to extend or withhold recognition to offshore asset protection as they see fit.

The treaty approach may not be practical. Some overseas jurisdictions might not be willing to accept the treaty’s conditions for recognition. In addition, the Senate might not be willing to approve such a treaty. Therefore, it may be necessary to consider another approach. One alternative, which might be promulgated by the American Law Institute or the National Conference of Commissioners of Uniform State Laws and eventually adopted by state courts or legislatures, would direct the courts to apply the law of the trust situs, or the law of the jurisdiction specified in the
trust instrument, if the conditions set forth below in subsection 3 are satisfied.

2. **Fraudulent Transfer Laws**

Fraudulent transfer laws are necessary to prevent abuse in connection with the transfer of property to offshore asset protection trusts. For this reason, American courts must continue to have the power to set aside all transfers that meet the statutory definition of “fraudulent.” The question is which fraudulent transfer law should control. Possible choices would include the law of the state where the settlor was domiciled when the transfer was made, the law of the forum state where the fraudulent transfer claim is made, or the law of the situs of the trust. This issue should be determined as part of the rule and not left to the courts to decide by applying vague choice of law doctrines.

The law where the settlor was domiciled at the time of the transfer appears to be the most logical choice. This is the law the settlor would look to at the time of the transfer. One might be tempted to choose the law of the forum state where a fraudulent transfer claim is made (assuming that it is different from the settlor’s domicile at the time of the transfer) simply because it would be the most convenient for the forum court to apply. However, it seems unfair to evaluate an act by standards that the settlor could not have known about when the transfer was made. In addition, such a rule might encourage forum shopping. On the other hand, there is also something to be said for applying the law of the situs of the trust. To be sure, fraudulent transfer laws in many offshore jurisdictions are generally weaker than those in the United States. Nevertheless, if the law of the trust situs is going to be applied to substantive provisions of an offshore trust, it makes sense to apply the law of the trust situs to determine the validity of the trust as well.

3. **A Proposed Rule**

State and federal courts, including federal bankruptcy courts, should apply the law of the trust situs to determine the validity of a self-settled offshore asset protection trust and the enforceability of its provisions if the following conditions are met: (1) the trust is irrevocable for at least ten years, the life of the settlor, or the life of an income beneficiary, whichever is the shortest; (2) the settlor has not retained any beneficial interest, other than a reversion, in the trust; (3) the settlor has not retained a power of appointment
nor has the right to act as trustee or trust protector; and (4) the settlor has agreed to retain a copy of trust instrument, and the trust instrument requires the trustee to render periodic accountings to the settlor and all trust beneficiaries.

a. **Irrevocability**

As the Tax Code recognizes, a settlor who can revoke the trust at any time has effective control over the trust property. Under these circumstances, it is unfair to protect the trust property against the claims of creditors while allowing the settlor access to it at any time. Consequently, to qualify for protection under my proposed rule, the trust should be irrevocable for at least ten years. The only exception would be to allow the trust to terminate at the death of the settlor or at the death of an income beneficiary.

b. **Retention of a Beneficial Interest**

It is one thing to allow the settlor to protect a nest egg, but it seems unfair to allow him to enjoy a present beneficial interest in the trust which is immune from creditors' claims. Consequently, the settlor should not be allowed to retain a mandatory income interest in the trust. On the other hand, a settlor should be able to retain a reversion in the trust. This would apply to a situation where the trust terminates after a certain length of time with the trust corpus reverting back to the settlor.

How should discretionary and support trusts be treated under this proposed rule? It is not uncommon for the trustee of an offshore asset protection trust to be given the power to make discretionary payments of principal or interest to the settlor or others. If the trust was a domestic self-settled trust, creditors of the settlor could reach all of the property in the trust that the trustee could potentially distribute to the settlor. However, under the law of the trust situs in most offshore locations, creditors would not be able to reach trust property that was subject to the exercise of discretion by the trustee because the settlor does not have a beneficial interest in that property. Although discretionary provisions are certainly capable of being abused, the law of the trust situs should be respected in this situation.

Support trusts are not commonly established in offshore locations. Unlike discretionary trusts, the beneficiary of a support

trust typically has an interest that is defined by an objective standard and which can be enforced against the trustee. Logically, if the settlor has retained a right to receive trust property for support, that interest should be subject to the claims of domestic creditors.

c. Exercise of Control over the Trust

The settlor should not be able to exercise formal control over the trust property, and instead should be forced to rely on the trust protector and the other beneficiaries to see that the trustee administers the trust properly. Accordingly, the settlor should not serve as a trustee or act as a trust protector because this would enable him to overrule or remove the trustee. However, I believe that the settlor should be able to serve on an advisory committee to the trustee. In addition, the settlor should be able to transmit an advisory letter of intent to the trustee when the trust is established. Finally, although anti-duress clauses and flight clauses serve a useful purpose by providing peace of mind and protection against hostile acts by the trustee or third parties, the settlor should not have the power to invoke these provisions.

d. Disclosure

Blind trusts should not be permitted. The settlor should be required to retain a copy of the trust. In addition, the trust instrument should require the trustee to provide the settlor and other beneficiaries with periodic accountings so they will know the value of the trust and where its assets are invested. This information need not be made public, but it should be subject to discovery during the course of any litigation against the settlor or if the settlor files for bankruptcy.

e. Special Creditors

Some provision should be made for certain “special creditors” even if they are not given special treatment in the trust situs jurisdiction. As mentioned earlier, courts in many states have invoked public policy considerations to allow special creditors to reach a debtor’s interest in domestic spendthrift trusts created by third persons. It would seem incongruous to treat offshore trusts any differently. The case for a child support exception is especially compelling. On the other hand, for the proposal to be consistent, it should respect the policy choices made by the trust situs
jurisdiction whenever possible. Therefore, the better approach is to reject any exceptions for spouses, children or other special creditors unless they are authorized by the situs jurisdiction. Instead, American courts can protect spouses and children in divorce situations by taking offshore trust property into account when they apportion marital property.

CONCLUSION

Despite the scorn heaped upon them by many American courts, offshore asset protection trusts serve useful social purposes. The approach that I have proposed above attempts to balance the interests of settlors, who are often simply trying to protect their hard-earned savings against dubious or unreasonable tort claims, and the interests of legitimate creditors. If this proposal, or a similar one, is adopted, state and federal courts may treat offshore asset protection trusts with more respect.