JURISDICTIONAL CONSIDERATIONS IN ESTABLISHING A PROTECTIVE TRUST

OFFSHORE TRUSTS: HOW THE LANDMARK CASES HAVE AFFECTED DRAFTING ISSUES AND SELECTION OF JURISDICTION

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I. INTRODUCTION. When approaching the question of asset protection planning, it is important to review the types of jurisdictions in which a protective structure might be sitused and the statutory and case law of those jurisdictions. To that end, this outline will first discuss the preliminary issues that must be considered when implementing a protective trust before focusing on selected foreign jurisdictions. It will then discuss the strengths and weaknesses of the recent asset protection trust legislation in certain U.S. states.

II. PRELIMINARY ISSUES. Before focusing on specific jurisdictions, it is important to consider the following general issues, always keeping in mind that the most protective structures are those that are completely severed from the United States.

A. <u>Aggressive Vs. Non-Aggressive Legislation</u>. One alternative is to seek the protection of those jurisdictions which have aggressive asset protection legislation (such as the Cook Islands, Gibraltar, and the Bahamas); however, some clients may take greater comfort in the fact that jurisdictional ties will be severed and that there is greater security in more established offshore financial centers (such as the Isle of Man, the Channel Islands, or Liechtenstein). However, even if the only objective is asset protection, it is not necessarily appropriate to select a jurisdiction that has aggressive legislation because a potential claimant could assert that the presence of aggressive

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asset protection legislation is the only reason one selects such a jurisdiction, thereby lending support to a fraudulent transfer claim.

There is an interesting dichotomy in the selection of a jurisdiction when the focus is on creditors' rights under fraudulent transfer law as opposed to when the focus is on creditors' rights under bankruptcy law. As suggested in the preceding paragraph, if the concern centers on fraudulent transfers, one might be well-advised to select a jurisdiction with non-aggressive legislation. On the other hand, such jurisdictions with aggressive legislation arguably provide more protection in the bankruptcy arena because, under bankruptcy law, the court is charged with determining what is "included" in the bankruptcy estate and must do so with reference to "applicable nonbankruptcy law."[1] The argument can certainly be made that the reference includes foreign law, and if, therefore, one has availed oneself of the protective statutes of the Cook Islands, for example, the assets should not be included in the bankrupt's estate and the court should grant the discharge.[2]

B. <u>Reluctance To Relocate Assets</u>. Another jurisdiction selection issue arises when a client does not want to move assets offshore. In such a case, even if there are no existing concerns about fraudulent transfers or bankruptcy discharges, one inevitably must choose a jurisdiction with highly specific asset protective legislation because such legislation is more likely to extend to assets not physically located in the applicable jurisdiction.

C. <u>Consider The Likely Origin Of A Claim</u>. This consideration will be very speculative because there should be no likely claims. Nevertheless, the nature of the client's activities may suggest that either a private party (e.g., medical malpractice claimant) or governmental agent (e.g., EPA demanding payments for environmental infractions) is the more probable plaintiff. A governmental claimant may well be able to achieve results in a foreign jurisdiction that a private party could not, particularly in a jurisdiction in which the U.S. is accustomed to dictating policy (for example, in the Caribbean). Additionally, marital claims may be more difficult to pursue in jurisdictions like Gibraltar or Bermuda because of the status of established precedent or statutory framework.

D. <u>Local Law.</u> Most foreign jurisdictions have some form of fraudulent transfer law or other regime designed to protect creditors or at least certain classes of creditors. These laws vary, as do the trust laws. Sometimes a settlor can be the sole beneficiary, sometimes a remainderman, sometimes a member of a class of current beneficiaries, and sometimes none of the above.

In the exercise of analyzing local law, there is a tendency to stop with the trust law and fraudulent transfer law. Other aspects of local procedural and substantive law that demand attention in a comprehensive review include the following.

- Rules regarding contingent fee contracts (e.g., are they permitted?) and the issuance of preliminary (or <u>Mareva</u>) injunctions[3]

- Theories for damages and the basis for amounts (e.g., are punitive damages allowed?)

- Rules regarding the awarding of attorney fees and court costs (e.g., is there a loser pay rule, and, if so, what is covered?)

- Statutes and case law on confidentiality

- Conventions or laws on the enforcement of foreign judgments

- Conventions or laws on allowing the taking of evidence (e.g., is the venue a party to the Hague Convention on taking evidence abroad?)

- Statutes and case law on conflicts of law

- Bankruptcy law

- Taxes

Such laws can, in fact, be as important as the basic trust law and fraudulent transfer law.

E. Economic and Political Stability. Great weight should be given to political and economic stability. Economic stability is typically integrated with political security, but not always. The ideal locale should have a certain economic substance measured by the status of its population, domestic output, infrastructure, and professional community. A healthy range in the choices of banks, accountants, trustees, attorneys, and investment advisors provides proof of a comforting level of professional and economic activity.

F. Costs. Of particular concern will be local fiduciary, legal, and accounting fees, formation costs, taxes (if any), etc. Obviously it is important to inquire in advance about all of these matters. As a general rule, reputable professionals in foreign jurisdictions have reasonable charges. Competition and professionalism seem to keep trustee, legal, and accounting fees at appropriate levels. It generally is advisable to consult with more than one attorney (or firm) and to inquire about that lawyer's charges as well as other costs and fees. Making it known that one will be conducting further inquiries before selecting professionals promotes competitive responses.

G. Transportation and Communications. Transportation and communications are very important. It is relatively easy to travel to most offshore jurisdictions, but certain issues need to be addressed.

- Does travel depend upon a politically sensitive connecting terminal?

- Do local holidays affect travel logistics?

Personal tastes are also a factor in the selection of jurisdiction. Some clients simply prefer to go to Europe and are comfortable there, while others may have the same attitude about the Caribbean.

H. Banks and Investment Advisors. Successful offshore trust structures require the participation of a foreign custodian bank. Thorough inquiries should be conducted regarding the bank's reputation, integrity, and fiscal solidity. The use of a branch of a well-known U.S. bank or an international bank must be carefully and cautiously considered. The bank's presence in other jurisdictions (for example, the U.S.) could compromise the level of protection otherwise afforded the client's assets.[4] Many banks in foreign countries have high quality money managers. However, it is not necessary to use the custodian's asset management personnel. Independent investment professionals can manage funds held by the custodian, providing flexibility to the structure.

I. Criminal Activities. One of the greatest risks in the use of an offshore trust is an erroneous choice of local professionals. In some offshore jurisdictions, there are trustees, lawyers, accountants, and bankers involved in tax evasion, money laundering, and perhaps other activities that are not necessarily illegal in the host country, but certainly are illegal under U.S. laws. Therefore, it is extremely important to be sure that one is dealing with honorable professionals. Obviously, references and professional listings are critical to the thorough examination of this issue.

The lawyer and client can also expect to be scrutinized by reputable professionals. Some foreign trustees, lawyers, bankers, and accountants who conduct their careers and lives in honest, ethical, and honorable fashions are wary of new business. Therefore, the attorney, as well as the client, might be asked for references and be subjected to fairly close examination. If one has thoroughly investigated the people with whom one has chosen to deal and presents them with detailed information and references, as well as with preliminary plans indicating intentions to plan aggressively but within the bounds of the legal and tax framework of the client's jurisdiction and the host jurisdiction, problems will be few. However, each jurisdiction and industry involved in the offshore trust business has enacted, or is in the process of enacting, more stringent due diligence requirements and procedures that will make establishing foreign structures more costly and time consuming in even the most transparent situations. As an example, the Swiss Bankers Association's Due Diligence Agreement (CDB 03), which was recently enacted to be effective July 2003, contains stricter "know your customer" rules in an attempt to establish the identity of the beneficial owner of assets. A copy of this Agreement is attached as Exhibit A.

J. Influences of Other Countries. Most offshore jurisdictions are small countries and are subject to the economic clout and political influence of larger countries. The U.S., for example, has the potential to force the Caribbean Basin Initiative on many Caribbean island countries. Many of the jurisdictions have some tie to the United Kingdom, which may retain powers over certain aspects of the international dealings of its former colonies or dependencies.[5] The impact of these relationships should be considered and evaluated.

III. OVERVIEW OF SELECTED FOREIGN JURISDICTIONS. Selection of a jurisdiction is a challenge. Due to the logistical difficulties of having reliable contacts in every possible country and due to the burden of trying to follow the laws and the political and economic climates of many jurisdictions, it is very tempting to select one country and then do "cookie-cutter" structures for all clients. The attorney practicing in this arena should resist that inclination and become knowledgeable about the legal and nonlegal issues relevant to various jurisdictions. There are important differences among jurisdictions and the scene is not static. What works for one client may not be best for another; similarly, what works best this year may not work best next year. Trustees and lawyers in many jurisdictions are marketing their respective countries as being optimal for asset protection. Like marketing materials of any salesman, the information is helpful, but requires careful scrutiny. The following presents an overview of certain offshore jurisdictions. The jurisdictions presented are representative of the types previously discussed (aggressive vs. nonaggressive legislation) and of various geographical locations.

A. <u>Bahamas</u>. The Bahamas is located in the western Atlantic Ocean off the coast of Florida. The capital and financial center of the Bahamas is Nassau, which is on the main island of New Providence. There is excellent airline service from the U.S. and a modern communications system. The Bahamas is an English speaking country with a common law legal system. Although completely independent of Great Britain, the Bahamas is still a member of the British Commonwealth. The official currency in the Bahamas is the Bahamian dollar, the value of which is equal to the U.S. dollar and is expected to remain so. The Bahamas is fairly stable politically, but there is substantial poverty and unemployment.

1. <u>Confidentiality</u>. Bahamian secrecy laws are codified in Section 15 of the Banks and Trust Companies Regulation Act, 2000. Despite attacks from the Organization for Economic Co-operation and Development (OECD) and the Financial Action Task Force (FATF), the Bahamas still maintains strict obligations of confidentiality and provides for severe criminal punishment for bankers or other professionals who reveal information about the identity, assets, liabilities, transactions, or accounts of a customer unless such disclosure is required by Bahamian law or the Bahamian courts, or unless the customer consents to the disclosure. The IRS has been successful, however, in penetrating bank secrecy in certain covert investigations, using suspect methods.[6]

Any encroachments on bank confidentiality that are allowed by Bahamian laws relate primarily to criminal conduct and to assisting Overseas Regulatory Authorities to fulfill their functions and responsibilities.

2. <u>Taxes</u>. The Bahamas is essentially a "no-tax" jurisdiction. It has no personal income tax, corporate income tax, value added tax, capital gains tax, withholding tax, gift tax, estate tax, or employment tax. Property taxes are imposed on both developed and undeveloped real estate. There are stamp duties on the sale of property and on most documents. Businesses and professionals operating in the Bahamas are subject to a business turnover tax on gross receipts from local sources.[7]

3. Fraudulent Disposition. Fraudulent dispositions are addressed by statute in the Fraudulent Dispositions Act, 1991. Under the statute, dispositions are voidable by the creditor prejudiced by the disposition if the transferor made the disposition with "an intent to defraud". The statute defines "intent to defraud" as an intention of the transferor to defeat willfully an obligation owed to a creditor, and the burden of proof for establishing such intent is on the creditor. The statute of limitations is two years from the date of the applicable disposition.

4. Trusts And Other Entities.

[a] Trusts Act. The Trusts (Choice of Governing Law) Act 1989 affords trusts protection from forced heirship laws in the settlor's home country and contains provisions addressing inbound and outbound redomiciliation. If Bahamian law is designated as the trust's governing law, such designation is binding and effective.

[b] Trustee Act. The Bahamas fairly recently enacted legislation (Trustee Act 1998) liberalizing the rules applicable to Bahamian trustees. For instance, trustees are now held to an "ordinary person" standard of care.[8] Furthermore, a trustee may now delegate any power or discretion vested in him as trustee to another person.[9] Finally, the new law gives trustees discretion not to inform even vested beneficiaries of the existence of the trust.[10] While clearly helpful from an asset protection standpoint, these provisions may create future difficulties for beneficiaries.

[c] International Business Company. Bahamian legislation also provides for the formation of an International Business Company (IBC). By combining an IBC with a trust, a double layer of confidentiality can be achieved.

5. Other Considerations.

[a] U.S. Influence. Because the Bahamian economy is heavily dependent on U.S. tourism, there exists the potential for U.S. influence on treatment of entities established there by U.S. citizens. While there does not appear to be any current movement in this direction, it should be considered in the selection of a jurisdiction.

[b] Grupo Torras S.A. et al v. S.F.M. Al-Sabah et al.[11] In this case, a Bahamian lower court judge determined that the Fraudulent Dispositions Act of 1991 would not insulate the defendant-trustee from a claim against the assets of the trust even if the two-year

statute of limitations for fraudulent conveyance claims had passed. The ruling, issued in 1995, gave way to considerable controversy about the continued validity of asset protection trusts in the Bahamas.

The case presented genuine issues concerning retention of control over the trust or its assets by the settlor that influenced the ruling. However, the non-application of the Act (and, therefore, the inability of the defendant to protect itself with a statute of limitations defense) turned on the fact that the court found that the assets were not actually *owned* by the settlor at the time he transferred them to the trust because the assets were acquired by the settlor by fraud.

In 1997, the Bahamas Court of Appeal limited the *Grupo Torras* ruling to the specific facts of that case. Although the lower court's ruling therefore is not legally precedential, as a practical matter, its existence on the books nonetheless somewhat diminishes the attractiveness of the Bahamas as an asset protection trust venue.

B. **<u>Bermuda</u>.** Bermuda is located in the Atlantic Ocean, approximately 600 miles due east from the North Carolina shoreline. It has regular air service with daily flights from New York, Boston, Atlanta, Philadelphia, Baltimore, and Toronto. Bermuda also has a state of the art communications systems. Bermuda, an English speaking country, is a common law jurisdiction. Bermuda is an old British "Overseas Territory" (former colony) and is part of the British Commonwealth. Bermuda may opt for independence from Britain but in a referendum in 1995 rejected this direction. The United Kingdom is responsible for defense and foreign relations; however, economically, Bermuda is more closely linked to the United States. Bermuda has a long tradition of stability and conservative government. The island has a balanced budget, is well-administered, and has a highly educated populace. Strict regulations and a conservative approach to business and socio-economic problems have resulted in the virtual absence of poverty, unemployment, and homelessness in Bermuda.

1. **<u>Confidentiality</u>.** There are no banking secrecy laws in Bermuda, but information is not readily available to third parties under English common law protection. Bermuda and the U.S. have a tax treaty that serves to implement some exchange of tax information provisions. However, the Attorney General must consult with an investigative committee before providing any information to foreign regulatory authorities.

2. **<u>Taxes</u>.** Bermuda is virtually tax-free. It does not have an income tax, gift tax, estate tax, business or value added tax, capital gains tax, sales tax, withholding tax, or accumulated profits tax. The majority of the government's revenue, approximately 32%, is earned from customs duties. Additional forms of taxation in Bermuda include a payroll tax, a departure tax, a motor vehicle fee, and a betting tax that is set at 20%.[12] Foreign ("exempted") companies incorporating in Bermuda can receive a guarantee exempting them from taxes until 2016.[13]

3. <u>Fraudulent Disposition</u>. Dispositions in fraud of creditors are addressed in several Bermuda statutes.[14] One such statute, Section 36 of the Conveyancing Act of 1983 (as amended by the Conveyancing Amendment Act 1994), must be considered in the context of trusts established for the purpose of protection from future creditors. Under Section 36, a disposition with "requisite" intent is voidable by the affected creditor. However, under Bermuda law, "requisite intent" does not necessarily involve deceit or dishonesty, rather the dominant purpose of the disposition must be to deprive existing or potential creditors of assets which otherwise would have been available to them. Insolvency of the settlor at the time the trust is established is a badge of fraud. Furthermore, the provisions of Section 36 might apply to future creditors arising within two years after the relevant disposition if the requisite intent is present. (Generally, causes of action accruing before the transfer or within two years after can be pursued; a creditor has six years from the date of the transfer to bring an action.) If it is clear that the primary purpose of establishing a Bermuda trust is something other than creditor protection (*e.g.*, estate, financial, or tax planning), Bermuda's fraudulent disposition law should not pose a problem, but caution is advised in this area.

4. <u>Trusts</u>. Bermuda is a good situs for the establishment of a trust, revocable or irrevocable, for the benefit of the settlor or his beneficiaries. However, trusts are subject to the rule against perpetuities. Bermuda passed specific laws governing trusts in 1989, The Trusts (Special Provisions) Act (the "Bermuda Act"). Among other provisions, the Bermuda Act contains language regarding a settlor's capacity to create a trust, provides for redomiciliation of a trust, addresses jurisdiction of the Supreme Court of Bermuda in trust matters, and provides for selection of the trust's governing law. Additionally, Section 11 of the Bermuda Act provides that in the absence of other Bermuda law or Bermuda public policy considerations to the contrary, a Bermuda trust cannot be varied or set aside by a Bermuda court pursuant to a law of another country regarding the effect of marriage, forced heirship, or insolvency of the settlor and creditor protection. Part II of the Bermuda Act has recently been amended to streamline Bermuda trusts for non-charitable purposes ("purpose trusts"). The Bermuda Act, among other things, now clarifies the conditions for the purposes of a purpose trust (sufficiently certain, lawful, and not contrary to public policy), does away with the requirement for a "designated person trustee" (*i.e.*, a Bermuda lawyer, accountant, or licensed trust company) and confirms the inapplicability of the rule against excessive duration and the application of the statutory perpetuity period (100 years). Development of trust law in Bermuda continues to keep pace with modern trends and provides flexibility in private and commercial contexts. Forthcoming legislation is expected on issues including trustees' investment powers and powers of delegation, and reform of the law relating to pension trusts.

5. Enforcement Of Foreign Judgments. Because Bermuda only has reciprocal enforcement of judgment agreements with the United Kingdom, the West Indies, Nigeria, and the States and Territories of Australia, a Bermuda court will generally only assume jurisdiction with respect to a foreign (*e.g.,* U.S.) judgment if: (i) the judgment debtor is a resident of Bermuda; or (ii) the judgment debtor has agreed to or voluntarily submitted to the jurisdiction of Bermuda courts (*e.g.,* by visiting Bermuda). It is unlikely that a Bermuda court would entertain an action to enforce a judgment against a U.S. settlor of a Bermuda trust. However, a judgment creditor or trustee in bankruptcy could attempt to bring an action against a Bermuda trustee on the grounds that the trustee holds property on "constructive trust" for the creditor (*i.e.*, the trust arrangement is a sham). To prove a constructive trust, the creditor would have to show either: (i) that the original trust fails either wholly or partially; or (ii) that the trustees hold the property as agents of the settlor.

C. Cayman Islands. The Cayman Islands are located in the western Caribbean. There is regular air service to multiple U.S. cities and modern communication systems. The Cayman Islands, an English speaking British colony, is a common law jurisdiction, is partially self-governing, and quite stable. Its economy is very healthy although the cost of living is high. The official currency is the Cayman Islands dollar.

1. Confidentiality. Under Cayman secrecy legislation there are substantial penalties for revealing confidential information. A foreign government cannot obtain assistance in pursuing criminal matters unless the offense is an offense under Cayman law. Tax crimes as such are not. However, the U.S., the United Kingdom, and the Cayman Islands entered into an agreement in 1988, the Mutual Legal Assistance Treaty, under which the parties will give each other information in certain drug investigations and white-collar crimes, including bank fraud. Furthermore, the legislation provides a mechanism for disclosure of information in limited circumstances; for example, in the course of a criminal investigation or when a bank must protect its own interests. If the person who is required to give evidence or make a disclosure resides in the Cayman Islands, that person must receive permission for such action from the Cayman Grand Court.[15]

2. Taxes. The Cayman Islands have no income tax, gift tax, estate tax, business or value added tax, property tax, accumulated profits tax, or capital gains tax. Certain guarantees against further taxes are available.

3. Fraudulent Disposition. Under the Fraudulent Disposition Law 1989, a disposition is voidable by a creditor prejudiced by the disposition if the disposition was made with "an intent to defraud." "Intent to defraud" is defined as an intention of the transferor to willfully defeat an existing obligation owed to a creditor, and the burden of proof for establishing such intent is on the creditor. The statute of limitations is six years from the date of the applicable disposition.[16]

4. Trusts. There are three types of trusts available under Cayman law: ordinary, exempted, and Special Trusts (Alternative Regime) ("STAR"). An ordinary trust parallels the general common law trust concept. An exempted trust has the added benefits of a fifty-year government guarantee against taxation and is not subject to the rule against perpetuities but is limited to a duration of one hundred years. The Special Trusts (Alternative Regime) Law 1997 establishes an alternative trust regime, applying to a trust if the trust instrument so provides.[17] A trust to which STAR applies is known as a "special trust."[18] STAR Trusts have several special features. For example, their objects may include non-charitable purposes, and it is up to the settlor to say who may have standing to enforce the trust. Additionally, the rule against perpetuities does not apply.[19] Cayman trusts of all types can relocate to a different situs under certain circumstances. Forced heirship rights of other jurisdictions are unenforceable against a Cayman *inter vivos* trust.

5. Other Considerations. The Cayman legislation is aggressive and is designed to attract trust formation by individuals from beyond its jurisdiction. In recent years, however, the Cayman Islands have come under considerable pressure from the U.S. to address the issue of money laundering in drug cases. This pressure has in part resulted from the Cayman Islands' notoriety as a money laundering center. While reputable Cayman bankers and lawyers carefully scrutinize new customers and expressly reject any illegal business, illegal activities are sure to continue there, and it is certain that U.S. pressure will continue to be brought to bear on the legislative process.

D. Cook Islands. The Cook Islands are located in the south Pacific Ocean east of Australia and south of Hawaii. The capital is Rarotonga, with a modern international airport and regular air services to Los Angeles, Hawaii, Tahiti, Fiji, and Auckland. The islands are remote from the world's major financial centers, but have modern communication systems. The Cook Islands are self-governing. Their closest link is with New Zealand, and they use New Zealand currency. English is the official language, and there is a common law legal system.

1. Confidentiality. The Cook Islands banking laws mandate secrecy about client information, with the penalty of one year imprisonment for a violation. In certain situations however, the Cook Islands' courts may have access to protected documents.[20]

2. Taxes. So long as an international trust organized in the Cook Islands does not do business there, it is exempt from tax. (The Cook Islands permits a trust's affairs to be administered by a Cook Islands trustee company, and this does not constitute "doing business" there for tax purposes.)

3. Fraudulent Disposition/Trusts. The Cook Islands enacted comprehensive trust legislation in the International Trusts Amendment Act 1989. The legislation addresses "International Trusts" ("ITs") and the effect thereon of fraudulent dispositions and bankruptcy. With respect to fraudulent dispositions, a creditor seeking to set aside a disposition must prove beyond a reasonable doubt that:

- the disposition was made with an intent to defraud that particular creditor; and
- the transferor was rendered insolvent by the transfer. (If the fair market value of the settlor's property after the transfer to the trust exceeds the value of the creditor's claim at the time of the transfer, there is no intent to defraud.)

If the creditor meets this burden, the transfer is not void or voidable. Instead, the transferor must pay the creditor's claim from property which would have been subject to its claim but for the transfer, that is, from property in respect of which the action is brought. The statute expressly states that an IT will not be void by virtue of the settlor's bankruptcy. The limitations provisions are the following.

- If a creditor's cause of action accrues more than two years before a transfer to an IT, the transfer will be deemed not to be fraudulent, unless proceedings in respect of that cause of action had been commenced at the date of the relevant transfer.
- Also, if a creditor fails to bring an action within one year from the date the transfer to an IT occurs, the action is barred.
- Furthermore, if the transfer (whether initial or subsequent) to an IT occurs before a creditor's cause of action accrues, such a disposition will not be fraudulent as to that creditor, and "cause of action" means the first cause of action capable of assertion against a settlor.
- Finally, an Amending Act provides that for redomiciled trusts, the limitations period commences at the time of original transfer, even when the transfer was to an offshore center other than the Cook Islands.

Another section of the legislation sets forth certain circumstances which will not be deemed badges of fraud. Fraudulent intent cannot be imputed from: (i) transfer to an IT within two years of the accrual of a creditor's cause of action; (ii) retention of powers or benefits by the settlor; or (iii) the designation of the settlor as a beneficiary, trustee, or protector.

4. **<u>Trusts</u>.** Retained powers and benefits are explicitly addressed by statute. An IT cannot be "declared void or be affected in any way" because the settlor: (i) has the power to revoke or amend the trust, to dispose of trust property, or to remove or appoint a trustee or protector; (ii) retains, possesses or acquires any benefit, interest, or property from the trust; or (iii) is a beneficiary, trustee, or protector.

The rule against perpetuities has been repealed, but an IT may use a perpetuities period if the parties so desire. Other provisions of the legislation make selection of Cook Islands law binding and conclusive, ensure that an IT is not subject to forced heirship laws of other countries, and require non-recognition of a foreign judgment against an IT, its settlor, trustee, and protector.

An Amending Act also provides that community property transferred to an IT retains its character as community property.

5. Other Considerations.

[a] Insularity. Unlike other offshore centers, the economies of which are tied closely to the U.S. or United Kingdom, the Cook Islands presumably would not be subject to economic or political pressure to relax secrecy provisions or reduce the benefits of entity formation for protective purposes.

[b] Comprehensive Statutory Scheme. The Cook Islands have one of the most comprehensive bodies of statutory law governing trusts and fraudulent conveyances. The level of comfort one obtains with such statutory certainty should be a factor to weigh against the inconvenience of traveling to this venue.

[c] 515 South Orange Grove Owners, et al. v. Orange Grove Partners.[21] In a 1995 decision appealing the issuance of a Mareva injunction against the trustees of an asset protection trust, the Court of Appeals in the Cook Islands found that a judgment creditor's action was not time-barred on the basis that the two-year statute of limitations on fraudulent conveyances in the International Trusts Act began to run on the date of the judgment against the settlor-transferor and did not commence when the cause of action accrued. Proponents of the Cook Islands legislation argued that the court misinterpreted the statute and rendered its judgment based on "bad facts."

The International Trusts Act was amended in 1996 to "cure" the possible ambiguity in the statute. Accordingly, while settlors can take comfort in knowing that the statute of limitations will begin when a potential judgment creditor's cause of action accrues, there remains at least some doubt as to which provision of the legislation might be susceptible the next time a court is presented with "bad facts" as it was in the Orange Grove case.

E. Gibraltar. Gibraltar is located off the southern coast of Spain. It has regular air service from London and modern communication systems. Gibraltar is a common law country that is a colony of the United Kingdom, and its constitution ensures that sovereignty will never be passed to another country against the will of the people of Gibraltar. The currency of Gibraltar is the Gibraltar pound, which is pegged to the British pound. English is the official language, but most inhabitants also speak Spanish.

1. Confidentiality. As more fully discussed below, trusts are subject to a limited disclosure requirement if protection under Gibraltar's fraudulent disposition statute, the Bankruptcy (Amendment) Ordinance 1990 (the "Ordinance"), is sought; however, the disclosed information is confidential. The Banking Ordinance 1992 imposes strict requirements of secrecy.

2. Taxes. There is a 35% income tax on local businesses, but no tax on capital gains. Gibraltar allows the formation of "exempt companies," which can conduct business anywhere but Gibraltar. These companies pay no income tax and can transact business from Gibraltar, but, in order to maintain exempt status, cannot do business with citizens or residents of Gibraltar. Similarly, income of a Gibraltar trust that is paid to a nonresident beneficiary is not subject to income tax.

3. Fraudulent Disposition. A disposition of assets by a nonresident settlor into a trust is not voidable by a creditor if:

- the settlor is an individual;
- the settlor is not insolvent at the time of the disposition;
- the settlor did not become insolvent as a result of the disposition; and
- the trust is registered in accordance with the Bankruptcy (Register of Dispositions) Regulations 1990.[22]

The effect of registration pursuant to Section 42A of the Ordinance is to negate the application of the 1571 Statute of Elizabeth, especially the cases that interpret intent to defraud creditors once a transfer of property has the result of defeating the rights of creditors. The problem however is that this protection only applies to transfers that fully comply with the conditions of Section 42A of the Ordinance, one of the conditions of which being that the transfer does not render the transferor insolvent. The definition of "insolvent" contained in Section 42A.(3)(b) is as follows: "insolvent" means in respect of a Settlor, any Settlor whose liabilities, both actual and contingent or prospective, exceed the value of his assets, [sic] Provided that no claim by creditors shall be deemed to be a contingent or prospective liability of a Settlor who at the time of making the disposition does not have actual notice of such a claim *or of the facts or circumstances which may render him liable to such a claim*;" (emphasis added). This definition of "insolvent" leaves open the question of whether the settlor had actual notice of "facts or circumstances which may render him liable" to a contingent or prospective claim.

In the case of professionals who may at some time in the future be liable for a claim based on facts or circumstances of which they are aware at the time that a transfer is made, even if no claim has been filed or threatened, it is possible given the wording of the statute that if a claim is made and later liquidated that the creditor will be able to argue that the transfer is not entitled to the protection of the Ordinance. Therefore, it is important to carefully consider whether Gibraltar is the appropriate situs for a trust when the settlor is involved in activities that might later give rise to a claim. Obviously, as case law develops in Gibraltar, the matter of the statute's wording will become more concrete. The registration process excludes therefore those with actual knowledge of a contingent or prospective liability.

The Statute of Elizabeth governs non-registered trusts.

4. **Trusts.** The Bankruptcy (Amendment) Ordinance 1990 and the Bankruptcy (Register of Dispositions) Regulations 1990 expressly establish the concept of an asset protection trust. An asset protection trust must be registered as described above, and the trustee must affirm that: (1) the settlor has completed forms establishing his or her financial position and revealing contingent or prospective liability; (2) the trustee has taken reasonable steps to substantiate the information received from the settlor; and (3) the settlor has given the trustee an affidavit of solvency. The registry is not open to public inspection and any information delivered to it is kept secret and confidential. The common law rule against perpetuities has been replaced by a 100-year limitation. Furthermore, Gibraltar law allows easy redomiciliation, and Gibraltar common law does not recognize forced dispositions from other jurisdictions.

5. **Trusteeship.** The 1990 legislation defines a trustee as "a company with a permanent place of business in Gibraltar and authorized by the Commissioner to act as a trustee." The regulations provide that the Registrar shall register a disposition of assets only when the trustee making the application:

- is the sole corporate trustee of the disposition;
- is judged by the Government (the Financial and Development Secretary) to have adequate financial and administrative resources to act as trustee in relation to the disposition;
- has obtained prior written approval from the Government of the inquiry forms administered to the settlor; and
- has indemnity insurance in an amount exceeding 1 million pounds.

Thus, it would appear that a corporate trustee with a Gibraltar situs is required with respect to Gibraltar trusts.

6. Enforcement Of Foreign Judgments. Judgments may be registered under specific reciprocal enforcement agreements with the U.K. and other Commonwealth countries, and the European Union. Judgments from other jurisdictions are not enforceable in Gibraltar. Claimants must sue under Gibraltar law.

F. Isle of Man. The Isle of Man is a British crown dependency situated in the Irish Sea and can be reached readily from London. English is the official language and it has modern communication systems. It is a common law jurisdiction and considered to be very stable.

1. Confidentiality. There is a strong tradition of confidentiality in the Isle of Man. Contractual agreements for the maintenance of a bank account generally prohibit the bank from divulging information regarding the client's affairs except by order of a Manx court or with the client's consent.

2. Taxes. There is no wealth tax, gift tax, estate tax, or capital gains tax in the Isle of Man. The Isle of Man does not tax nonresidents upon bank interest or income arising outside the Island. This principle extends to companies which are beneficially owned abroad and trusts with nonresident settlors and beneficiaries. Manx source income other than bank interest is taxed at 20%, which is the sole rate of tax on the income, net of necessary expenditures, of companies and trusts which do not claim nonresident status.[23]

3. Fraudulent Disposition. The Manx government is reluctant to introduce specific statutes for the encouragement of asset protection trusts, believing that frivolous claims would be dismissed under existing law and fearing to disadvantage legitimate claimants. Currently, fraudulent dispositions are covered by the Fraudulent Assignments Act 1736 and the decisions under it and the general law of the Isle of Man, for example by the Companies Act 1931 to 1986 and by The Theft Act 1981. However, the Isle of Man's position with regard to fraudulent dispositions was clarified by In Re Heginbotham 1999 (Common Law Division, 15 February 1999). In it Deemster Cain ruled as follows, "A state of insolvency implies an inability to pay existing, or present debts. A person is not in a 'state of insolvency' merely because he may not be able to pay contingent or future debts, which may never materialise. . . . I would construe the term 'present debts,' however, to include known and ascertained debts which are to fall due on a date in the future. A transaction or contrivance designed to deprive known and ascertainable future creditors of timely recourse to property which would otherwise be applicable for their benefit. . . . would not be honest in the context of the relationship of debtor and creditor and would not therefore be bona fide."

4. Trusts. The law of trusts is governed by the Isle of Man Trustee Act 2001. Provisions found in this legislation are similar to those contained in the

English statutory and case law regarding trusts. The Isle of Man Trustee Act 2001 governs the powers and duties of trustees, provides for the advancement of capital and income to beneficiaries, and governs the appointment and retirement of trustees. Other pertinent Manx legislation includes the Variation of Trusts Act of 1961 and the Manx Perpetuities and Accumulations Act of 1968, as those Acts have been amended by the Trustee Act 2001. In the “Edwards Report” changes were suggested to Manx trust law and the recent amendment to the Trustee Act is a direct result of this report.[24]

5. Perpetuities Period. For instruments made prior to 1 January 2001 the perpetuity period is eighty years. For instruments made subsequent to 1 January 2001 the perpetuity period is one hundred fifty years.[25]

6. Enforcement Of Foreign Judgments. While U.S. judgments are not recognized, the Isle of Man recognizes judgments from the following countries: Guernsey, Israel, Italy, Jersey, the Netherlands, Sumatra, and the United Kingdom.

G. Jersey. Jersey is the largest Channel Island and is located in the English Channel between France and England. In 933 the island became part of the area now known as Normandy, which today is a *département* of northern France. In 1204 the United Kingdom lost control of mainland Normandy, but Jersey remained loyal to the United Kingdom and has ever since. During the 20th century, a constitutional convention developed declaring that the United Kingdom will not interfere in matters of purely domestic concern or taxation.[26] Nevertheless, the United Kingdom retains responsibility for Jersey’s relations with foreign countries and its defense. Externally, Jersey’s political stability benefits from its geographical location and its settled links with the United Kingdom and the European Union. Internally, political life is marked by the absence of political parties with candidates for the States (Jersey’s parliament) almost invariably standing as independent candidates on the basis of local issues. The local economy is based mainly on finance, tourism, and agriculture. Although the official language of the Jersey court is French, the use of English is permitted and adopted in almost all proceedings. There is no exchange control in Jersey. Monies in any currency may flow into and out of the island.

1. Confidentiality. The Jersey courts have indicated that the rule laid down by the English Court of Appeal in *Tournier v. National Provincial and Union Bank of England*—declaring that a banker owes his customer a contractual duty of confidentiality, subject to certain limited exceptions—is applied in relation to banking matters in Jersey. Any breach of this duty could give rise to a claim for damages.[27] The duty is imposed with the opening of an account whereupon information about the customer should not be released by the bank. The duty of confidentiality goes beyond the state of the account and beyond the time that the account is closed. It extends to all transactions through the account and to information obtained from other sources resulting from the banking relations of the bank and the customer.

The circumstances in which disclosure can or must be made without the customer's consent pursuant to the *Tournier* decision have been modified and extended by statute over recent years. Examples of such laws are:

- The Bankers Books Evidence (Jersey) Law 1986;
- The Company Securities (Insider Dealing) (Jersey) Law 1988;
- The Drug Trafficking Offenses (Jersey) Law 1988;
- The Investigation of Fraud (Jersey) Law of 1991; and
- The Prevention of Terrorism (Jersey) Law 1996.

Provisions in the Banking Business Law enable the Finance and Economics Committee to obtain information from Jersey banks for the purpose of their supervisory functions.

2. **Taxes.** The only significant tax featured in Jersey tax planning is the income tax, a standard rate of 20%. As a general rule, a nonresident of Jersey is only liable for income tax on income arising in Jersey and, by concession,[28] this excludes Jersey bank interest. The administration of income tax is in the hands of the Comptroller of Income Tax. Both the comptroller and staff of the comptroller are required to take an oath of secrecy before the Royal Court and are bound by the oath not to disclose details of taxpayers to anyone except to the extent required in the event of a prosecution for an offense under the tax laws.[29] There are no capital taxes, inheritance taxes, or general purchase taxes. Certain limited excise duties are levied on alcohol, tobacco, and motor fuel purchased in Jersey. Jersey is included in the European Union for the purposes of the Common Customs Tariff. Accordingly, Jersey must apply the common external tariff to imports of goods into the island from countries outside the Common Customs Tariff area, but is not itself subject to the common external tariff in respect of exports of goods to countries within the Common Customs Tariff area. Jersey is outside the European Union for the purposes of value added tax. Persons owning or occupying Jersey realty are liable to pay rates administered by the parishes of Jersey. Other sources of revenue take the limited forms of stamp duty, payable in respect of transfers involving Jersey realty, and probate duty, related to the value of estate assets situated in Jersey. Additionally, companies are required to pay annual registration and renewal fees and Treasury duty on the creation or increase of authorized share capital, payable at a rate of 0.5% of the nominal or par value of the shares, subject to a minimum duty of £50. In Jersey, the mechanism of withholding tax on certain payments is used not only as a means of tax collection but also, in some cases, as a means of giving tax relief. Non-Jersey residents and exempt companies are not normally required to withhold tax on payments. Where probate of a will or letters of administration are obtained in Jersey, stamp duty is calculated according to the value of the estate situated in Jersey.

3. Fraudulent Disposition. Because Jersey law has its roots in Norman customary law, the Statute of Elizabeth has never had effect on the island. Thus, the Jersey position with regard to fraudulent disposition is largely nonstatutory. With respect to dispositions which are governed by Jersey law, *Golder v. Société des Magasins Concorde Limited* is the leading case.[30] The court in that case found that in order to set aside a disposition, the creditor has to prove the intention to defeat creditors and their actual defeat by showing that the debtor is insolvent and that his insolvency was a result of the act being challenged.

Dispositions by transferors resident or carrying on business in Jersey are also covered by the Bankruptcy (*Désastre*) (Jersey) Law 1990 under which certain dispositions (which might include a disposition to a trust) may be unwound by the Royal Court if they are made at an undervalue. Under this law,[31] a person enters into a transaction at an undervalue:

- within five years prior to a declaration en désastre (where the debtor is insolvent at the time of or becomes insolvent as a consequence of the transaction); or

- otherwise within two years prior to the declaration en désastre; the Viscount (the Officer of the Royal Court charged with the administration of the désastre proceedings) may apply to the Royal Court for such order as it thinks fit for restoring the parties' positions to what they would have been if the debtor had not entered into the transaction.

4. Trusts And Other Entities. In 1984 the existence of trusts was put on a statutory basis with the enactment of the Trusts (Jersey) Law of 1984, which is known generally as "the Trust Law." The central provision of the Trust Law is that a valid trust is created wherever a trustee-beneficiary relationship exists for a charitable or, subject to the requirements of the Trust Law, noncharitable purpose.[32] The Trust Law draws a fundamental distinction between Jersey trusts and foreign trusts.[33] The Trust Law has only a few provisions that relate specifically to foreign trusts, providing simply that they are governed by and interpreted in accordance with the relevant proper law subject only to certain exclusions as to legality and public policy.[34] Some provisions of the Trust Law relate to both foreign and Jersey trusts. These include a measure of personal liability of directors of trustee companies,[35] the rule that the trust property is not available to the trustee's personal creditors,[36] some protection for third parties dealing with a trustee,[37] and the three-year period of limitation of actions.[38] With regard to Jersey trusts, the Trust Law mainly restates traditional trust principles as known in English law, although there are some differences. Most importantly, Jersey trusts are generally valid and enforceable in accordance with whatever lawful terms the settlor chooses to establish.[39] As such, the provisions of a trust may be written in almost any way, and may provide any degree of flexibility between completely fixed trusts (where the interest of the beneficiaries are decided at the outset) and totally discretionary trusts (where the interest of the beneficiaries are at the discretion of the trustees).

No particular formality is required for the creation of a Jersey trust. The trust property must only be held by the trustee, and the terms of the trust must be lawful and clear. The beneficiaries of a trust must be identifiable by name or ascertainable by reference to a class or relationship with some person.[40] An express power may be included in the trust for the addition or exclusion of persons to or from the class of beneficiaries.[41] Beneficiaries may disclaim their interests under the trust.[42] Any property except Jersey realty may be held in a Jersey trust.[43] Jersey realty may, however, be held indirectly in trust (*e.g.,* through a holding company). Subject to the terms of the trust, after provision of the initial assets, further assets may be added to the same trust. Indeed, the most common arrangement is to start with a purely nominal initial trust fund and to add the "real" assets later.

5. <u>Enforcement Of Foreign Judgments</u>. No direct enforcement of a judgment of a foreign court can occur until it is registered in Jersey. Foreign judgments are capable of being registered in Jersey if they fall within the Judgments (Reciprocal Enforcement) (Jersey) Law 1960. Jersey can direct to which country the 1960 Law applies; these include England, Wales, Scotland, Northern Ireland, the Isle of Man, and Guernsey. The judgment (i) must be of a superior court and must be final and conclusive, (ii) must be for the payment of a liquidated sum of money not with respect to taxes, fines, or penalties, and (iii) must not have been given prior to 1960. The law provides for the setting aside of the registration of a foreign judgment. The court will set aside registration if it considers, among other things, that the foreign court had no jurisdiction to hear the original action. Registration will also be set aside (i) if the foreign judgment does not fall within the 1960 Law, (ii) if the defendant was not given due notice of the foreign proceedings, (iii) if the foreign judgment was obtained by fraud, (iv) if the enforcement of the foreign judgment would be contrary to Jersey public policy, or (v) if the rights under the foreign judgment are not vested in the applicant.

Once registered, a foreign judgment has the same force and effect for the purposes of execution as a judgment given by the Royal Court itself. If a foreign judgment cannot be registered, the judgment creditor will have to sue on the judgment debt, in a similar manner to any other creditor suing on an ordinary debt, in order to be able to enforce it in Jersey.

H. <u>Liechtenstein</u>. Liechtenstein is a small principality located between Switzerland and Austria. It is necessary to fly to Zurich, then drive or take a train to reach Liechtenstein. Liechtenstein is a very stable, civil law country, with strong ties to Switzerland. The Swiss franc is the legal tender of Liechtenstein. The official language is German, though English is often used. The capital of Liechtenstein is Vaduz.

1. Confidentiality. Liechtenstein's enforcement of bank secrecy is even greater than that of Switzerland, providing heavy sanctions for breach of professional secrecy. Liechtenstein has a tax treaty with Austria only, and a customs union with Switzerland. Attorney/client and fiduciary/beneficiary privileges are very strong in Liechtenstein.

2. Taxes. A nominal Capital Tax of 0.1% is levied upon entities if they are involved in investments and/or commercial activities outside Liechtenstein. Thus, the nominal Capital Tax is levied upon entities involved in investment (*i.e.*, non-commercial) activities, such as the Trust, Establishment, and Foundation discussed below. For assets located in the country owned by persons domiciled in the country, estate, inheritance, and gift taxes are imposed. Liechtenstein entities are also subject to value added tax (VAT) of 6.5%.

3. Fraudulent Disposition. A Liechtenstein statute regarding claims by creditors provides that creditors of a settlor can only bring a claim against trust property under fraudulent conveyance law or in accordance with the law of donations or succession. A creditor under this rule must acquire a judgment that is enforceable in Liechtenstein. Thus, while there is not the kind of statutory limitation in Liechtenstein found in other jurisdictions regarding what constitutes a fraudulent disposition, judgments from other jurisdictions are difficult to enforce in Liechtenstein. A creditor with a foreign judgment must bring the action anew in a Liechtenstein court, which requires, among other things, a deposit of 10% to 15% of the judgment and/or a sum which will cover potential attorneys fees. Liechtenstein law expressly disallows contingent fee contracts and punitive or exemplary damage awards and the losing party must pay all fees and costs of both sides.

Liechtenstein law contains a statute of limitations in connection with dispositions in fraud of creditors.

- A creditor must bring a claim within one year of the transfer in order to set the transfer aside unless the debtor acted with intent to damage the creditor, in which case the limitations period is five years.

- If, however, a creditor serves a brief on the trustee via the Liechtenstein court system informing the trustee of its intention to set aside the transfer, and does so within the five-year statutory period, the time to file suit is extended to ten years from the date of transfer.

4. Trusts. Although a civil law jurisdiction, Liechtenstein law recognizes several trust and trust-like entities.

[a] The Trust. Liechtenstein is the only country in Europe with a detailed law of trusts. The Liechtenstein law of trusts is based on codification of an Anglo-American model. Contrary to common law, however, Liechtenstein trust law does not contain a rule against

perpetuities; a Liechtenstein trust may therefore exist for an unlimited period of time. Redomiciliation is very easy in Liechtenstein. Purpose trusts may be created for any purpose as long as it is not illegal, immoral, or impossible.

[b] The Establishment (*Anstalt*). The Establishment is an autonomous fund with its own legal personality which exists to serve the interests of one or more beneficiaries named by the Establishment's founder. The founder may name himself as either the sole beneficiary or one of a number of beneficiaries. Under Liechtenstein law, an Establishment is liable only for its own commitments. This characteristic, combined with the flexibility provided by Liechtenstein law for designing an Establishment to suit individual needs, makes the Establishment an excellent vehicle for family wealth planning.

[c] The Foundation (*Stiftung*). The Foundation is a legally recognized dedication of assets to a particular purpose. The purpose of a Foundation might be, for example, to provide for a particular family. The purpose and management of the assets of a Foundation are effected in accordance with instructions issued by the founder of the Foundation.

I. Nevis. Nevis is located in the eastern Caribbean, 225 miles southeast of Puerto Rico, and is in the same time zone as the eastern United States. Nevis was settled under British rule in 1793. However, since 1988, Nevis and St. Kitts have comprised a single sovereign nation. Rated among the world's most stable countries, Nevis has exhibited a vibrant multi-party political system and deep-seated respect for human and property rights. The economy of Nevis, with virtually 100% employment and one of the highest per capita incomes in the Caribbean, is highly stable. The official language of Nevis is English. The currency is the Eastern Caribbean dollar, and there are no exchange controls applicable to offshore businesses.

1. Confidentiality. The Confidential Relationship Act of 1985 applies to all those in the financial community, including, but not limited to, banks. Anyone disclosing banking, financial, and trust documents without court order is subject to criminal penalties, including fines or imprisonment.

2. Taxes. While Nevis collects several taxes from businesses engaged in business onshore, offshore trusts, offshore corporations, and offshore limited liability companies are tax exempt so long as they do not transact business on the island.[44] These entities only pay an annual government fee of $200. The government has a narrow definition of what constitutes doing business in Nevis. Maintaining bank accounts in Nevis, holding board meetings in Nevis, maintaining corporate or financial records in Nevis, maintaining an administrative or managerial office in Nevis with respect to assets and activities outside of Nevis, being a partner in a Nevis partnership, or acquiring real property in certain industrial or tourist facilities in Nevis approved by the government will not constitute doing business in Nevis.

For corporations doing business on the island, tax rates are as high as 40% of net income. However, the government is willing to provide tax holidays, tax reductions, and import duty waivers to businesses contributing to the economic well being of the island as a whole.[45]

As offshore trusts are not permitted to own property on the island, there is no property tax applicable to offshore trusts.

The present government of Nevis and the opposition party, which was in power from 1983 to 1992, have both expressed the intention of enacting no future taxation of offshore trusts and companies.

3. Fraudulent Disposition. The Statute of Elizabeth[46] is specifically repealed in Nevis for international trusts.[47] Instead, Nevis adopted the Nevis International Exempt Trust Ordinance (the "Ordinance") which provides that:

- a creditor must prove beyond a reasonable doubt that the trust was settled or established, or property disposed to a trust with the principal intent to defraud creditors;[48] and

- a creditor must prove beyond a reasonable doubt that the settlement, establishment, or disposition rendered the settlor insolvent.[49]

If both of these are established by the plaintiff, the trust shall only be liable to the extent that the settlor had an interest in the contributed property immediately after the settlement, establishment or disposition.[50] These remedies in the Ordinance are the exclusive remedies, whether by statute, in equity, or at common law, that a creditor, defined as any person who alleges a cause of action,[51] has against the settlor, a trust or any person who transfers property to a trust on behalf of a settlor.[52]

4. Trusts And Entities. At the time of its enactment in September 1994, the Ordinance was among the most comprehensive asset protection trust laws in the world. The main focus of the Ordinance is to provide asset protection strategies. The Ordinance, among other things, provides for spendthrift trusts, overrides the common law rule against perpetuities, overrides forced heirship, repeals the Statute of Elizabeth, and prohibits the enforcement of foreign judgments. Prior to 1994, all trusts, domestic and international, were subject to the Trustee Ordinance of 1961. While domestic trusts remain subject to the 1961 law, international trusts are now governed by the Ordinance.

Nevis limited liability companies provide the members of the LLC with full protection from company obligations, similar to a corporation,[53] while simultaneously permitting them to contractually form a company that is best tailored to fit each situation, similar to a partnership.[54] Unique among offshore LLC statutes, the Nevis LLC statute provides asset protection through an exclusive charging order remedy[55] and estate planning opportunities through strict valuation provisions in compliance with IRS dictates.[56] Also unique to the Nevis LLC statute is the ability to form an LLC with only one member.[57]

Known in the vernacular as NBCOs, reflecting the name of the authorizing legislation—the Nevis Business Corporation Ordinance, 1984—Nevis' offshore corporations are formed when articles of incorporation are filed with the registrar. An NBCO may be used for international commercial and financial ventures, as a private trust company to be the trustee of a Nevis trust, as an offshore bank, or as an open end investment company.

5. Enforcement Of Foreign Judgments. Foreign judgments are not recognized if the judgment is based upon law that is not consistent with Nevis law.

IV. DOMESTIC VENUES FOR ASSET PROTECTION TRUSTS.[58] Alaska, Delaware, Nevada, Rhode Island, and Utah (the "Domestic Venues")[59] have enacted legislation with a view toward becoming viable venues for establishing asset protection trusts. This trend of domestic asset protection trust legislation could be due to the states' desire to bolster the local economy by keeping wealth onshore in local financial institutions and by drawing wealth from other states. It could also be due to the fact that state legislators have realized that fraudulent transfer law offers sufficient protection to creditors against transfers to protective trusts (thus negating the need for the all-out prohibition of self-settled spendthrift trusts of most states' spendthrift trust legislation). Whatever the reason, it is possible that we are seeing the beginning of a trend that, like spendthrift trust legislation at the turn of the twentieth century, will result in every state eventually enacting some sort of asset protection trust statute.

A. The Uniform Fraudulent Transfer Act. Because fraudulent transfer law is so tightly intertwined with the workings of the asset protection trust statutes in the Domestic Venues, a preliminary discussion of the Uniform Fraudulent Transfer Act is helpful to understand the differences among these trust statutes. All of the Domestic Venues, except Alaska, have adopted the Uniform Fraudulent Transfer Act (UFTA) in some form. The UFTA is a comprehensive statute drafted in an attempt to remove as many ambiguities as possible from fraudulent transfer law, and is intended to have the same meaning in every adopting jurisdiction. As a result, clarification of UFTA language has been resolved through litigation.

1. Fraudulent Transfer Defined. A "fraudulent transfer" is generally defined as a transfer of assets that is made with the intent to defeat the rights of creditors. In certain situations, fraudulent transfers can be voided, and the creditor can thus reach the transferred assets to satisfy a debt. In certain circumstances, the UFTA allows creditors to void transfers as fraudulent without showing any "intent to defraud" on the part of the debtor. And in those situations in which a creditor must prove a debtor's "intent to defraud," creditors are given the benefit of eleven "badges of fraud" by which the court may infer intent.[60]

2. <u>Two Types of Creditors and What They Must Prove.</u> For the purpose of determining what must be proved in court, the UFTA divides creditors into two categories: present creditors (those whose claim arose before the transfer) and future creditors (those whose claim arose concurrent with or after the transfer). Both classes of creditors are allowed to void transfers on a "constructive" fraud theory (*i.e.,* without having to either prove actual intent to defraud or to rely on the presence of badges of fraud) if the debtor made the transfer in exchange for less than "reasonably equivalent value," and the debtor was either left with an unreasonably small amount of assets for the business or transaction in which she was engaged (or in which she was about to engage), or the debtor intended to incur debts beyond her ability to pay them when they came due.[61] Thus, because a transfer in trust is usually not for "reasonably equivalent value," chances are good that such a transfer can be voided as fraudulent by the settlor's creditors if the other factors are present.

Both present and future creditors can also void transfers made with "actual intent to hinder, delay or defraud."[62] However, this intent does not have to be proven with regard to the specific creditor making the claim. A creditor can void a transfer as long as he can show that it was made with the intent to hinder, delay, or defraud *any* creditor.[63] Furthermore, a creditor does not have to prove actual fraudulent intent—the UFTA lists certain recognized badges of fraud from which the court can infer that the debtor made the transfer with the intent to defraud creditors.[64] These badges of fraud include insolvency, transfers to insiders, retention of possession or control by the debtor, and transfer of substantially all of the debtor's assets.[65]

In addition to the methods for voiding transfers described above, the UFTA gives present creditors even greater protection. Without having to show any intent, a present creditor can void transfers made for less than "a reasonably equivalent value" by debtors who are actually insolvent before the transfer is made, or who are made insolvent by the transfer.[66] The UFTA defines insolvency as either the inability of a debtor to pay debts as they become due ("the income test"), or the circumstance in which the value of a debtor's overall debts exceeds the overall value of her assets ("the balance sheet test").[67] Present creditors may also void transfers made by insolvent debtors in respect of antecedent debts to insiders who have reason to know of the debtor's insolvency.[68] For individual debtors, "insiders" specifically include (but are not limited to) relatives, partnerships of which the debtor is a general partner, and corporations of which the debtor is a "director, officer, or person in control."[69] Because the definition of "insider" is not limited to the above-named persons or entities, a creditor could argue that the trustee of a self-settled spendthrift trust is an insider and should know that the settlor was insolvent at the time of the transfer.

3. Limitation Periods Under the Uniform Fraudulent Transfer Act. The limitation period under the UFTA differs depending on the basis of a creditor's cause of action. A creditor attempting to void a transfer on the basis of the debtor's "intent to defraud" must bring her suit within four years after the transfer was made or the obligation was incurred, or, if later, within one year after the transfer or obligation was, or reasonably could have been, discovered by the claimant.[70] For actions to void transfers based on the debtor's failure to receive "reasonably equivalent value" from the transferee, a creditor has four years from the date of the transfer, whether or not he could have reasonably discovered the transfer.[71] For transfers made by an insolvent debtor in satisfaction of a debt owed to an insider who had reason to know of the insolvency, and whose claim arose prior to the claim of the creditor who was defrauded by the transfer, the limitations period is only one year.[72] This very short one-year limitation period reflects the UFTA's balanced approach toward protecting creditors while at the same time encouraging debtors to pay off oldest debts first. This philosophy is reflected in an even more striking way with regard to various commercial transactions (for example, transfers made in the ordinary course of business of the debtor and the insider) in which transfers are not voidable *at all*, even though the transfer itself was fraudulent as to a creditor.[73]

B. Domestic Venue Asset Protection Trust Legislation.

1. The Alaska Trusts Act. Alaska first enacted protective trust legislation[74] in 1998. Since that time, Alaska has amended its statutes several times, the most recent being an amendment that was signed into law on July 10, 2003. This new legislation also amended Alaska's fraudulent transfer laws,[75] and the effect of the amendments is to afford greater protection to trust assets against the claims of creditors. For instance, Alaska law now clearly states that the only creditors who can void a transfer to an Alaska trust are creditors *of the settlor*, an issue that was unclear from the wording of the Alaska statutes before the 2003 amendments. Furthermore, the Alaska laws were amended so that a creditor seeking to void a transfer as fraudulent must prove that the transfer was made with the intent to defraud that very creditor[76]—this is quite a deviation from the UFTA, which allows a creditor to void a transfer if he shows that the transfer was made with the intent to defraud *any* creditor.[77] Another notable addition to the Alaska statutes is a provision that voids any agreement or understanding, express or implied, between the settlor and the trustee that attempts to grant, or permit the settlor to have, greater rights or authority than stated in the trust instrument (such as a "Letter of Wishes").[78] This new provision mimics Delaware's statute.[79] The 2003 amendments also added a provision that excepts mandatory distributions from charitable remainder trusts from the provision that allows a creditor to reach trust assets if the settlor retains a right to mandatory distributions.[80] And to protect against fraudulent transfers, A settlor who creates a protective trust for his own benefit must, before transferring assets to the trust, sign a sworn affidavit stating that, among other things listed in the statute, he is solvent and is not making the transfer with the intent to defraud creditors.[81] This is referred to an Affidavit Regarding Financial Condition, which diligent attorneys practicing in the foreign trust area have always required of their clients. The 2003 amendments apply retroactively to trusts created before the effective date of the amendments, with the exception of the requirement that the settlor sign an affidavit of solvency, which applies only to trusts created on or after the effective date of the amendments.

[a] **Fraudulent Transfers Under Alaska Law.** Alaska, unlike the other three Domestic Venues, has not enacted the UFTA. Its statute simply declares that transfers are void if made with an "intent to hinder, delay, or defraud" creditors.[82] Even though the 2003 amendments have attempted to make the Alaska fraudulent transfer statute inapplicable to protective trusts that satisfy the trust law requirements (as stated in the following paragraph), a discussion of Alaska fraudulent transfer law is still warranted. This is because an Alaska court would still likely interpret the trust law's "intent to defraud" language in the same way as it would under the fraudulent transfer statute, and may rely on precedent established under that law to determine whether a transfer should be voided as fraudulent.

Unlike the UFTA, the Alaska fraudulent transfer law makes no attempt to define the term "creditor," leaving the class of plaintiffs as broad as the courts wish to make it. In fact, the Alaska fraudulent transfer statute voids transfers made with an intent to hinder delay, or defraud creditors "or other persons" of their lawful claims—a definition that could potentially include unknown future creditors, a class of creditors that the UFTA does not include in its definition of "creditor." Previously, the Alaska Trusts Act mirrored this language by stating that a transfer of property in trust would not be protected if the transfer was intended to "hinder, delay, or defraud creditors or other persons under [the Alaska fraudulent transfer statute]." The 2003 amendments deleted this reference to the fraudulent transfer statue, and the trust law now states that a creditor can reach assets only if the creditor is (1) a creditor of the settlor and (2) the transfer was made with the intent to "defraud that creditor." This provision is now much more protective than the UFTA, which allows a creditor to void a transfer that was made with the intent to defraud *any* creditor. The 2003 amendments to Alaska's trust law also made the limitation periods for fraudulent transfer actions less creditor-friendly than under the prior law. As amended, Alaska's trust law generally requires present creditors of the settlor to file suit within four years from the date of the transfer. A present creditor may also bring an action within one year from the date the creditor could have "reasonably discovered" the transfer if the creditor either (1) can demonstrate, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer, or (2) files a suit that asserts a cause of action based on an act or omission of the settlor that occurred before the settlor transferred assets to the trust.[83] In effect, this provision greatly restricts the class of present creditors who are able to reach trust assets, and it obviates the concern under the prior version of the statute that a creditor-friendly court could extend the limitations period forever by declaring that the creditor could not have "reasonably discovered" the transfer until just before he or she brought suit.

At first glance, one of the potential key advantages of Alaska's fraudulent transfer statute seems to be that it does not acknowledge the existence of "badges of fraud," which are circumstances surrounding the transfer that, by themselves, are considered evidence of an intent to defraud (and thus easing a creditor's burden of proof). However, the Supreme Court of Alaska has repeatedly acknowledged the existence of at least eight badges of fraud in its opinions.[84] Six of these badges are quite similar to items on the UFTA list of badges of fraud. But two are much broader than any of the UFTA badges.

First, Alaska courts consider *depletion* of the assets of a transferor so as to hinder or delay creditor recovery to be a badge of fraud.[85] The UFTA considers transfers that render the debtor "insolvent" to be suspect, but the Alaska precedent as established by its Supreme Court would allow a creditor-friendly court to go much further. In fact, it can be argued that the creditor would not be in court at all unless his attempts at recovery were "hindered or delayed" by a depleting transfer.[86]

Second, Alaska's list of badges of fraud includes transfers made when the relationship between the transferor and transferee is such that "there are circumstances which of themselves incite distrust and suspicion."[87] The UFTA recognizes "transfers made to insiders"[88] as a badge of fraud, but the Alaska language could include almost anyone, allowing a court to view virtually any relationship as suspicious. Specifically, the relationship between a settlor and the trustee of his or her self-settled trust would seem by its very nature to fit within "circumstances which of themselves incite distrust and suspicion."

The Alaska fraudulent transfer statute does not specify a burden of proof for a creditor seeking to establish that a fraudulent transfer took place. In most states, civil fraud (including fraudulent transfer) must be proven by "clear and convincing evidence," a very high standard for a creditor to meet. In Alaska, the burden of proof is by a "preponderance of the evidence," the burden of proof in most civil lawsuits.[89] This means that a creditor needs much less convincing evidence to void a transfer in Alaska than in most other states. Therefore, due to the combination of (i) broadly described badges of fraud, and (ii) a low standard of proof, a creditor presumably could have *less difficulty* voiding transfers under Alaska law than under the law of most other states.

[b] **<u>Recognition of Other States' Judgments in Alaska</u>.** A creditor who obtains a final judgment in another state must bring an action to enforce that judgment in Alaska within ten years of the date of the judgment.[90]

[c] **<u>Recognition of Foreign Money-Judgments in Alaska</u>.** Alaska has adopted the Uniform Foreign Money-Judgments Recognition Act, which could potentially affect the integrity of an Alaska asset protection trust. This act requires Alaska to recognize and enforce all foreign judgments that grant or deny recovery of a sum of money "in the same manner as the judgment of a sister state which is entitled to full faith and credit."[91] As long as the judgment was rendered by an impartial tribunal having valid jurisdiction, judgment against the settlor anywhere in the world could potentially result in delivery of trust assets to the creditor. In addition, the law requires no reciprocity for enforcement. Therefore, whether the rendering country would give an Alaska judgment the same effect is irrelevant.[92] Hence, although an Alaska judgment would be unenforceable in every offshore jurisdiction where asset protection trusts commonly are settled, any judgment rendered in a foreign country would be given the equivalent of full faith and credit in Alaska.

[d] **<u>The Availability of Punitive Damages and Attorney's Fees in Alaska</u>.** When a creditor sues to have a transfer rendered void as fraudulent, the creditor often seeks both attorney's fees and punitive damages. Under Alaska law, all costs, including attorney's fees, are awarded to the victor in all civil lawsuits.[93] This provision discourages frivolous lawsuits but is an anomaly in United States law. Punitive damages are awarded only for torts,[94] but that does not necessarily preclude a creditor-plaintiff from receiving them. Although a creditor's underlying cause of action may be based on contractual principles, he or she may have a specific tort claim (such as civil fraud) related to that action.[95] Also, even though there appears to be no law specifically on point in Alaska, fraudulent transfer claims are generally considered tort actions in that they are classified as civil fraud cases. In such a case, the possibility of both punitive damages and attorney's fees is present

and could cause the creditor's award to rise far above his actual damages.

2. <u>The Delaware Qualified Dispositions in Trust Act</u>. The Delaware Qualified Dispositions in Trust Act[96] provides that a transferor may make a disposition of property in a trust and also be a discretionary beneficiary of the trust if the trust expressly names Delaware law as the governing law of the trust (except in the case of a disposition to a qualified trustee by a non-qualified trustee[97]), is irrevocable, and contains Delaware's statutory spendthrift language.[98] As long as the settlor is not made a mandatory beneficiary, the assets in trust are free from the claims of the settlor's creditors.[99] However, the protection from creditors does not extend to (a) existing claims for alimony or support of a spouse, former spouse, or children, (b) a division of marital property, and (c) tort claimants.[100]

In June of 2003, Delaware amended its trust law to provide that, in any action brought against a trustee of a Delaware protective trust, if a court declines to apply the law of Delaware "in determining the validity, construction, or administration of such trust, or the effect of a spendthrift provision" of the trust, then the trustee will immediately—without further order of any court—cease to be trustee of that trust.[101] Upon the trustee's ceasing to be trustee, the trustee's only power is to convey the trust property to the successor trustee named in the trust instrument, or if no successor is named, to the trustee appointed by the Delaware Court of Chancery.[102] (This amendment is effective retroactively to all Delaware trusts that meet the requirements of the Delaware Qualified Dispositions in Trust Act.[103]) Presumably, the Delaware legislature added this provision based on a supposition that the successor trustee named in the instrument or appointed by the Court of Chancery would not be subject to the jurisdiction of a non-Domestic Venue court, and therefore, the creditor would be forced to bring his action in a Delaware court, which would apply Delaware law.

While this new provision doesn't appear to violate the full faith and credit clause of the U.S. Constitution[104] (which applies only to final judgments), it has three major practical weaknesses. First, if trust assets are located in a non-Domestic Venue, the non-Domestic Venue court can still exercise jurisdiction over the new trustee.[105] This would negate the protection that the new Delaware legislation was intended to provide. Second, if a non-Domestic Venue court finds that Delaware's trust laws offend public policy in that state, it would arguably ignore this new provision and continue to treat the "removed" trustee as if she were still serving as trustee.[106] The third weakness is that a Delaware trust would likely be drafted to mimic the new statutory language, causing the trustee to be removed if the court attempts to apply non-Domestic Venue law to the trust. A non-Domestic Venue court could find that this trust provision also violates public policy and is therefore void; in any event, such a trust provision may very well result in enraging the judge and in gaining judicial sympathy for the claimants.

Despite these weaknesses, the Delaware legislature must be commended for its creative attempts to push itself ahead of the other Domestic Venues for asset protection trusts.

[a] **Fraudulent Transfers Under Delaware Law.** Delaware has passed a version of the UFTA,[107] but the Delaware Qualified Dispositions in Trust Act modifies the UFTA statute of limitations framework. Under the limitations set forth in Delaware's trust law, a future creditor is allowed only four years from the date of the transfer, regardless of the theory under which they are proceeding[108] (where, under the UFTA, future creditors may bring an action under a theory of "actual intent" within one year after the creditor "could reasonably have discovered" the transfer[109]). Furthermore, the Delaware trust law provides that a trustee may make a qualified disposition,[110] and that the date of the original transfer to the trustee counts toward the statute of limitations period.[111] These alterations to the UFTA limitations make Delaware's asset protection trust framework decidedly pro-debtor. A further pro-debtor aspect of the Delaware trust law is that a creditor must prove his fraudulent transfer case with "clear and convincing evidence"[112] (which is the highest burden of proof in court), even if badges of fraud are present.

But despite the pro-debtor language of the statute, there is some Delaware case law that seems to be cause for concern from a debtor's point of view. In at least two Delaware cases, the burden was *shifted to the debtor* when the transfer in question was between blood relatives.[113] In other words, to avoid summary judgment, a debtor must come forward with some evidence showing an *absence* of the intent to defraud. This is typically quite difficult to prove and is therefore an extremely creditor-friendly position. Both cases were decided before Delaware enacted the UFTA and the Qualified Dispositions in Trust Act, however, so the extent of their precedential value is doubtful, especially considering that the trust law expressly places the burden of proof on the creditor.[114]

[b] **Recognition of Other States' Judgments in Delaware.** Unlike the other Domestic Venues, Delaware's civil statutes do not set forth a limitation period for actions to enforce a judgment from another state—so a judgment creditor could bring this type of action at any time. Delaware's trust law, however, limits the time within which actions to enforce a judgment against a protective trust must be brought. The statute states that an action to enforce a "judgment entered by a court or other body having adjudicative authority . . . [is barred] if, as of the date such action is brought, an

action by a creditor . . . would be barred under this section."[115] In other words, a judgment creditor who seeks to satisfy a judgment out of a Delaware trust must bring his action for enforcement within the limitation periods set forth in the trust law.

There is a very strong argument that this provision is unconstitutional under the full faith and credit clause[116] of the U.S. Constitution. It is true that the enforcement of a sister state's judgment may be barred by the statute of limitations of the forum state because statues of limitations are deemed to affect procedure only and not the substance of the action.[117] And some have argued that, because the Delaware law makes no distinction between its own judgments and those of other states, it does not run afoul of the full faith and credit clause.[118] But upon closer analysis, this provision of Delaware's statute begins to look less like a procedural bar than a substantive one. This will be best illustrated with an example. Assume that a creditor brings two separate fraudulent transfer claims in Texas against two different debtors: the first debtor transferred assets outright to his sister who lives in Delaware, and the second debtor transferred assets to a Delaware trust. In each action, the Texas court, after determining that its jurisdiction is proper, decides that the creditor was indeed defrauded by the transfer and enters a judgment voiding the transfer and allowing the creditor to recover the fraudulently-transferred property. The creditor then takes his valid Texas judgments to Delaware for enforcement. Because Delaware's civil statutes provide no limitation period for actions to enforce judgments from other states, the creditor is not barred as to the first debtor, who fraudulently transferred assets to his sister, and the Delaware court is bound by the full faith and credit clause to recognize the Texas judgment. But if the creditor doesn't attempt to enforce his second judgment against the Delaware trust within the short time limitation set forth in the statute, he has no remedy—and arguably, he has been denied the only remedy available to him. But, some may argue, a Delaware creditor would be equally barred. This is true, but it ignores the fact that the full faith and credit clause requires states to recognize the valid, binding judgments of other states; and prohibits courts from questioning the substance of other state's judgment. Because the Delaware statute states that enforcement actions are barred "if, as of the date such action is brought, an action by a creditor with respect to such qualified disposition would be barred under this section,"[119] it is effectively asking the Delaware court to inquire into what type of creditor (present or future) obtained the judgment and under which theory (actual or constructive intent) the creditor obtained a judgment against the debtor before deciding whether that creditor's enforcement action is barred. In essence, the Delaware statute limits other states' rights to control the substantive issues before their courts and to expect their decisions to be enforced in other states. An argument may also be made that, under the UFTA, the creditor is not limited to recovering only the fraudulently-transferred property, but may recover a judgment for the value of the asset transferred,[120] and thus, the creditor can enforce his judgment against other assets besides those in the qualified trust. But the fact that the creditor has other avenues of enforcement does not change the fact that the Delaware statute requires Delaware courts to question the substance of other states' judgments, as prohibited by the full faith and credit clause.

[c] **Recognition of Foreign Money-Judgments in Delaware.** Delaware has also adopted the Uniform Foreign Money-Judgments Recognition Act, which, like the Alaska version of the Act, requires Delaware to recognize and enforce all foreign judgments that grant or deny recovery of a sum of money "in the same manner as the judgment of a sister state which is entitled to full faith and credit,"[121] regardless of whether the foreign jurisdiction would recognize a Delaware judgment.

[d] **Availability of Attorney's Fees and Punitive Damages in Delaware.** Like Alaska, Delaware law requires that costs be awarded to the victorious party in civil lawsuits.[122] These costs do not include attorney's fees, which are excluded by statute.[123] Delaware follows the majority rule for punitive damages as well: they may only be awarded in cases involving contracts when the plaintiff's cause of action is actually based in tort.[124] That position might be problematic, however, for a debtor in a fraudulent transfer action. A fraudulent transfer action is generally classified as "civil fraud," and hence, a tort. A judge might award punitive damages, especially when confronted with a trust specifically intended to allow the settlor/debtor to enjoy assets while shielding them from otherwise valid claims of creditors.

3. The Spendthrift Trust Act of Nevada. In order to qualify as a protective trust in Nevada, the trust must be irrevocable and all or part of the trust corpus must be sitused in Nevada. The settlor must be domiciled in Nevada, or if the settlor is not domiciled in Nevada, the trust must have a "qualified trustee" as defined by the trust statute. The settlor may be a discretionary beneficiary of trust principal and income.[125]

[a] **Fraudulent Transfers under Nevada Law.** Like Delaware, the Nevada trust law alters the UFTA limitation periods,[126] but Nevada's alteration of the limitation appears to be more debtor-

friendly than Delaware's. For example, *all* present creditors, regardless of the theory under which they are proceeding, must bring an action within two years after the transfer is made, or within six months after the creditor reasonably should have discovered the transfer. Furthermore, *all* future creditors are barred after two years, with no allowance for whether the transfer "reasonably should have been discovered" at a later date.

[b] **<u>Recognition of Other States' Judgments in Nevada</u>.** Nevada has the shortest limitation period for enforcing another state's final judgment. An action to enforce a judgment from another state must be brought in a Nevada court within six years after the date of the judgment.[127]

[c] **<u>Recognition of Foreign Money-Judgments in Nevada</u>.** Nevada has not passed a law calling for the recognition of foreign money-judgments. Nevada courts would only be required to enforce a foreign judgment if a treaty requiring recognition existed between the United States and the nation in which the judgment was rendered.

[d] **<u>The Availability of Attorney's Fees and Punitive Damages in Nevada</u>.** In Nevada, attorney's fees are awarded to a prevailing party only if they are authorized by a particular statute.[128] Because Nevada's version of the Uniform Fraudulent Transfer Act does not allow for the recovery of attorney's fees, it appears that the victor of a fraudulent transfer claim would not be able to recover them. But a Nevada court has discretion to award attorney's fees if it determines that the "defense of the opposing party was brought without reasonable ground."[129] Although there is no case on point in Nevada, it is possible that a prevailing creditor could argue that a settlor's defense of the action was brought without reasonable ground, if the facts so indicate, and thus recover attorney's fees. Lastly, Nevada also allows punitive damages in cases of civil fraud.[130]

4. <u>The Rhode Island Qualified Dispositions in Trust Act</u>. The Rhode Island Qualified Dispositions in Trust Act[131] is very similar to the Delaware Legislation. Because the Rhode Island and Delaware Acts are so similar, and because both states have adopted the UFTA, this outline will only point out the major differences between the two. First, Rhode Island requires an asset protection trust to expressly name Rhode Island law as the governing law of the trust in all cases—it does not, as Delaware does, carve out an exception for a disposition by a non-qualified trustee to a qualified trustee. Second, where Delaware's statute clearly states that a creditor must prove his fraudulent transfer case with "clear and convincing evidence," Rhode Island's statute is silent. And third, Rhode Island's modifications of the UFTA's limitation periods, unlike Delaware's modifications, may have some unintended pro-creditor aspects. In fact, before recent amendments to the Delaware law, the Delaware legislation was identical to Rhode Island's—these amendments may indicate that lawmakers in Delaware were aware of the pro-creditor weaknesses in the original statute.

To illustrate why the limitations set forth in Rhode Island's statute may be pro-creditor, it is best to contrast it with Delaware's current (post-amendment) statute. Both trust laws state that the trust law's limitation period applies, "notwithstanding the provisions of [the UFTA]" But this phrase is placed in two completely different parts of each statute—and it is this placement that makes the critical difference. In the Delaware trust law, only the subsection governing *future creditors* applies "notwithstanding" the provisions of the UFTA. Rhode Island's statute, on the other hand, applies to both future *and* present creditors "notwithstanding" the provisions of the UFTA. To clarify the discussion that follows, we should look at the two statutes side by side. The "notwithstanding" phrase of each statute has been highlighted for emphasis.

Delaware (12 DE ST §3572)	**Rhode Island (RI ST §18-9.2-4)**
(b) A creditor's claim [for fraudulent transfer] shall be extinguished unless: (1) The creditor's claim arose before the qualified disposition was made, and the action is brought within the limitations [for present creditors under the UFTA]. (2) **<u>Notwithstanding the provisions of [the UFTA]</u>**, the creditor's claim arose concurrent with or subsequent to the qualified disposition and the action is brought within 4 years after the qualified disposition is made.	(b) **<u>Notwithstanding the provisions of [the UFTA]</u>**, a creditor may not bring an action [for fraudulent transfer] if: (1) The creditor's claim against the transferor arose before the qualified disposition was made, unless the action is brought within four (4) years after the qualified disposition is made or, if later, within one year after the qualified disposition was or could reasonably have been discovered by the creditor; or (2) The creditor's claim against the transferor arose subsequent to the qualified disposition, unless the action is brought within four (4) years after the qualified disposition is made.

The effect of Delaware's statute is to override only the UFTA's limitations that apply to future creditors. Thus, in Delaware, all future creditors are barred after four years, regardless of the cause of the action under which they are proceeding. This is decidedly debtor-friendly in comparison to the UFTA, which allows future creditors to bring an action within one year after the transfer "could reasonably been discovered" if the creditor's action is based on the transferor's "intent to defraud." As discussed before, this part of the UFTA could effectively result in no real limitation period in a creditor-friendly court. For present creditors in Delaware, the UFTA's limitation periods still apply.

In contrast to the Delaware statute, the effect of the Rhode Island statute is that the *entire* UFTA limitations framework is superceded by the trust law. This has two possible pro-creditor results. First, actions by present creditors to void "transfers to an insider for an antecedent debt" may be brought within four years of the transfer (see subsection (b)(2) of the Rhode Island statute above), where under the UFTA, these actions are allotted only one year. Second, present creditors can take advantage of the (possibly unlimited) limitations extension for transfers that "could not have reasonably been discovered" in *any* cause of action they bring (see subsection (b)(1) of the Rhode Island statute above), where under the UFTA, this extension is available only for present creditors' claims based on the debtor's "intent to defraud." One debtor-friendly aspect of the Rhode Island limitations, however, is that, like Delaware's statute, future creditors are completely barred after four years, regardless of whether they allege an "intent to defraud" (while the UFTA allows future creditors to extend this period if the transfer could not have reasonably been discovered until a later date).

While the above analysis has not been substantiated in a Rhode Island court, the amendments to the previously-identical Delaware statute hint that the Delaware legislators guessed that the prior statute would be interpreted this way.

A further difference in the Rhode Island and Delaware limitations statutes is that, in Delaware, a trustee who makes a qualified disposition can count the date that the trustee originally received the property toward the statute of limitations period. Rhode Island, however, does not allow a trustee to make a qualified disposition at all.

All of these differences reveal that Rhode Island should consider amending their trust law the way that Delaware amended its law if it wants to remain competitive as a Domestic Venue for asset protection trusts.

[a] **Recognition of Other States' Judgments in Rhode Island.** Of the four Domestic Venues that have civil statutes limiting the time in which an action to enforce an out-of-state judgment must be brought, Rhode Island has the longest limitation period: twenty years.[132]

[b] **Recognition of Foreign Money-Judgments in Rhode Island.** Rhode Island has not passed a law calling for the recognition of foreign money-judgments. Thus, like Nevada, Rhode Island courts would only be required to enforce a foreign judgment if a treaty requiring recognition existed between the United States and the nation in which the judgment was rendered.

[c] **<u>The Availability of Attorney's Fees and Punitive Damages in Rhode Island</u>.** The prevailing party in a civil lawsuit in Rhode Island is entitled to recover all costs.[133] The term "costs," however, does not include attorney's fees.[134] As for the availability of punitive damages in the fraudulent transfer context, they will generally only be awarded when the defendant's actions "are so willful, reckless, or wicked that they amount to criminality."[135] Whether adequate facts exist to support an award of punitive damages is a question of law for the court to decide,[136] and once the court has determined the case to be a proper one for punitive damages, the finder of fact will decide, in its discretion, whether the plaintiff is entitled to such an award.[137] One can certainly imagine a case egregious enough to allow an award of punitive damages in a fraudulent transfer action.

5. <u>Utah: The Newest Domestic Venue</u>. The Utah Legislature has just passed asset protection trust legislation, to be effective on December 31, 2003. In order for a trust to qualify as a protective trust in Utah, it must be irrevocable, the settlor must not be a mandatory beneficiary,[138] and the trustee must be a "trust company" as defined in the Utah statutes.[139] The spendthrift trust language in a Utah trust is not valid for any interest in real property that the settlor transfers to the trust.[140] The new Utah trust legislation applies only to trusts created on or after May 5, 2003.

[a] **<u>Fraudulent Transfers under Utah Law</u>.** Interestingly, the Utah asset protection trust legislation is contained within Utah's Uniform Fraudulent Transfer Act.[141] This alone seems to resolve any confusion about the interaction between the trust law and the UFTA: any provision in the trust law that contradicts other provisions of the UFTA would govern a fraudulent transfer action against an asset protection trust.

The most notable provision of the new law is that all creditors—both present and future—are limited to "actual intent" claims when attempting to satisfy a claim out of a trust that meets the statute's requirements.[142] Of course, a creditor attacking a Utah trust under this theory would be given the benefit of the eleven badges of fraud set out in the UFTA[143] to prove intent, but this provision appears to make the Utah trust legislation quite debtor-friendly.

A seemingly creditor-friendly aspect of the law, on the other hand, is that it allows any creditor, without having to prove any other elements of a fraudulent transfer, to reach trust assets if the transfer renders the settlor insolvent.[144] The UFTA generally allows a creditor to set aside a transfer that renders the debtor insolvent only if the transfer was also made for less than "a reasonably equivalent value."[145] By removing the need to prove that the transfer was also made for less than a reasonably equivalent value, Utah lawmakers may be envisioning a situation in which a settlor sells assets to a trust for fair market value and then squanders the proceeds of the sale so that his creditors cannot fulfill the debt. Utah's trust law appears to prohibit such a two-step transaction. Alternatively, the Utah legislators may just be recognizing the fact that transfers to a trust are usually for "less than a reasonably equivalent value," and thus the need to prove this element under the UFTA is an unnecessary step in a fraudulent transfer action against an asset protection trust.

The trust law also sets out its own statute of limitations framework, which shortens the UFTA's limitation periods slightly: present creditors must bring their claims within three years of the transfer or within one year after the transfer is, or reasonably could have been, discovered by the creditor, and future creditors have only two years after the transfer within which to bring their claims.[146]

Lastly, unlike the other Domestic Venues, the new Utah legislation explicitly provides protection for trustees or "anyone involved in the counseling, drafting, preparation, execution, or funding of the trust" against any claims for aiding a fraudulent transfer.[147] A person may assert a cause of action only against the trust assets or the settlor,[148] and satisfaction of a claim is limited to only that part of the trust to which it applies.[149] Though some may argue that this protection could cause attorneys and trustees to be lackadaisical in their due diligence and know-your-customer policies, this aspect of the statute provides needed protection for innocent attorneys and trustees who could be misled by settlors who hide their true financial condition and claim to make transfers for valid reasons.

[b] **<u>Recognition of Other States' Judgments in Utah</u>.** A creditor must bring an action to enforce another state's final judgment in a Utah court within eight years of the judgment.[150]

[c] **<u>Recognition of Foreign Money-Judgments in Utah</u>.** Like Nevada and Rhode Island, Utah has not passed a law calling for the recognition of foreign money-judgments. Similarly, a Utah court would only be required to enforce a foreign judgment if a treaty requiring recognition existed between the United States and the nation in which the judgment was rendered.

[d] **<u>The Availability of Attorney's Fees and Punitive Damages in Utah</u>.** A Utah court must award attorney's fees to a prevailing party if "the court determines that the action or defense to the action was

without merit and not brought or asserted in good faith."[151] Thus, it is possible that the court could find that a settlor's defense of a creditor's lawsuit meets these requirements and award attorney's fees to the creditor. And Utah case law suggests that punitive damages are available in a lawsuit based on fraudulent transfer.[152]

C. **Domestic Venue Asset Protection Legislation Vulnerabilities.**

1. Judicial Vulnerabilities. In addition to fraudulent transfer claims, other legal theories are available to judgment creditors attempting to reach trust assets, such as: (1) there is an implied agreement between the settlor and the trustee, making the trust's asset protection features fail under Domestic Venue law itself; (2) the asset protection features of the Domestic Venue trust offend public policy in the state where the post-judgment action is brought, and thus the governing law of the trust (Domestic Venue law) should be ignored in favor of the law of the non-Domestic Venue state;[153] (3) the Domestic Venue trust is a "sham" trust, or is the "alter ego" of the settlor, meaning that the settlor never really parted with dominion and control over the trust assets, and therefore, the court should disregard the trust structure; and (4) the exemption laws of the non-Domestic Venue should apply to the trust assets, and thus those assets are not protected from creditors' claims. Furthermore, if a creditor prevails on one of these theories, a court could try to pressure an uncooperative settlor to turn over trust assets by jailing her for civil contempt.

[a] **Implied Agreement.** It is possible that a creditor could reach the trust assets by arguing that it doesn't meet the requirements of the Domestic Venue law itself. Because many of these trusts will be used chiefly to provide asset protection, the settlor will be the primary (or only) beneficiary. He or she may also be a co-trustee, a protector, or otherwise retain significant control over the trust. A court faced with these facts might be very receptive to an argument that there is an implied agreement between the settlor and the trustee regarding distributions to the settlor. If so, the settlor would not really be a "discretionary" beneficiary as the Domestic Venue laws require,[154] and thus the settlor should not be allowed the spendthrift protection afforded by those laws. This argument is not available in Alaska and Delaware, however, because their statutes make any express or implied agreement between the trustee and the settlor void as a matter of law.[155]

[b] **Governing Law and Public Policy.** A court that has determined that its jurisdiction is proper must decide whether to apply its own state's law or the governing law of the trust (*i*.e., Domestic Venue law). The general rule for trusts is that courts will apply the governing law of the trust.[156] But there is an exception to this rule. If the state where a court exercises jurisdiction has a sufficiently strong public policy against a pertinent provision of the governing

law of the trust, the court will ignore the governing law provision of the trust agreement and substitute its state's law to resolve the matter before the court.[157]

One of the key provisions of the Domestic Venue laws is the allowance of self-settled spendthrift trusts. As discussed at the beginning of this section, all other states have either statutory or case law that voids self-settled spendthrift trusts for public policy reasons.[158] If the court outside of a Domestic Venue decides that this rule is a sufficiently strong tenet of its state's public policy, the court may decide to ignore the asset protection provisions of the Domestic Venue statute in favor of its own and declare the trust assets reachable by creditors, thereby eliminating the protection that the trust was designed to achieve.[159] Trust assets located in the non-Domestic Venue jurisdiction are particularly vulnerable in this situation because the court has jurisdiction over them and can order that they be turned over to the creditor.

[c] **Alter Ego and Sham.** Even if a non-Domestic Venue court were to apply Domestic Venue law, a creditor could still attack the trust on a number of other grounds. For instance, if the facts indicate a relationship between the trustee and the settlor suggesting that the settlor did not, in fact, part with dominion and control over the trust assets, the creditor might persuade a court to disregard the trust structure because it is a sham[160] or the alter-ego[161] of the settlor. The case law in this area has generally been developed in the offshore asset protection trust area, but there is nothing to indicate that a sympathetic court would not apply these theories to a Domestic Venue trust. In fact, these theories may be easier to pursue against a domestic trust because discovery by the creditor to reveal facts supporting these arguments will be accomplished under U.S. procedural rules, which have been promulgated under the due process guarantees of the Constitution. This contrasts sharply with discovery attempts in foreign countries concerning facts related to foreign trust activities, which may be a fairly burdensome, if not impossible, task on the part of the creditor.[162]

[d] **Exemptions.** Whether assets are exempt from the claims of creditors is determined by the law of the forum.[163] In other words, when a creditor asks a Domestic Venue court to enforce a sister state's judgment against the settlor of an asset protection trust created under Domestic Venue law, the Domestic Venue court would most likely use Domestic Venue exemption laws to determine which assets the creditor could reach. The asset protection trust laws of Alaska and Delaware, for example, exempt self-settled discretionary trusts from claims of both the settlor's and

the beneficiaries' creditors. Accordingly, an attempt by a creditor to enforce a judgment against the settlor of a self-settled discretionary trust in a Domestic Venue would be unsuccessful if the creditor could not prove a fraudulent conveyance, an implied agreement, or that the trust is a sham or is the alter ego of the settlor.

But if an Alaska or Delaware court were sympathetic to the creditor, it is possible that the court could employ another state's exemption law. The Restatement of Conflict of Laws permits the law of the forum to give way when another state has the dominant interest in the matter before the court.[164] The court could decide that another state (such as the debtor's domicile) has a more significant interest in the matter and use that state's law. If the other state has no exemption for assets held in self-settled discretionary trusts, the trust assets might no longer be protected.

[e] **Civil Contempt.** A fairly recent development in the area of offshore asset protection trusts deserves some mention in the domestic asset protection trust context. The now-notorious case of *Federal Trade Commission v. Affordable Media*[165] (known as "the Anderson case") gained its notoriety from the fact that the settlors were jailed for six months for civil contempt due to their refusal to repatriate assets transferred to a foreign asset protection trust; other courts have followed suit.[166]

In the past, concerns about imprisonment were often answered by the principle that impossibility is a defense to civil contempt.[167] That is, an individual cannot be jailed for failing to perform an act that is impossible to perform. But the growing body of precedent for jailing settlors for civil contempt is evidence of the fact that courts are becoming increasingly intolerant of debtors who claim impossibility in a contempt proceeding when the impossibility was "self-created." For instance, one court stated that, "if [the debtor] cannot convince the trustees or Trust Protector to return his assets to him, it is a problem of his own making."[168] If faced with bad enough facts, a court could just as easily use this reasoning to incarcerate a settlor of a Domestic Venue trust.

2. Constitutional Vulnerabilities. Although all five statutes appear to offer substantial asset protection (especially against the claims of future creditors), none of these states can be as protective a site for establishing trusts as an offshore jurisdiction because they are a part of the United States and are, therefore, bound by the United States Constitution. By virtue of the "full faith and credit" mandate in the Constitution,[169] a Domestic Venue's courts must recognize judgments rendered under the laws of non-Domestic Venue states. In addition (and as more fully discussed below), the enactment of laws enabling asset protection trusts may itself violate the Constitution's contracts clause,[170] which prohibits states from enacting any law that substantially impairs the obligations of parties to existing contracts or makes them unreasonably difficult to enforce. Finally, due to the supremacy clause[171] of the Constitution, no state statute can protect debtors from conflicting federal law (such as bankruptcy law).

[a] **Full Faith and Credit Clause Issues.** The threshold issue in analyzing the Domestic Venue legislation under the full faith and credit clause is whether the trustee is a necessary party to all suits involving trust assets. In the fraudulent transfer context, there is a strong argument that due process requires that the transferee be joined.[172] Because a fraudulent transfer is valid as between the parties, and the transfer is generally viewed to be only "voidable" by a court, rather than void *ab initio*,[173] the transferee has a legal right in the property that due process affords him the chance to protect, and should thus be joined in the action. If this is the case, most discussion of the full faith and credit clause is moot because, unless the trustee is subject to the jurisdiction of a non-Domestic Venue court, the creditor would have to bring suit in the Domestic Venue in order for the dispute to be properly adjudicated. Thus, barring application of one of the legal theories discussed in the above sections (implied agreement, alter ego, etc.), the plaintiff would find himself in a forum that is generally friendly to the trust, and the trust assets would nearly always be protected.

Whether due process requires a transferee to be joined in a fraudulent transfer action still remains to be seen. However, it is well-settled that due process allows a plaintiff to sue a non-resident if that person has minimum contacts with the forum state[174] or if the non-resident owns assets in the state that are also the subject of the litigation.[175] In this context, the Domestic Venue statutes do not go far enough to protect the assets or the trustee of a protective trust from being subject to the jurisdiction of a non-Domestic Venue court. Alaska, for instance, allows a non-resident to serve as a co-trustee,[176] and requires only "some or all" of the trust assets to be located in Alaska.[177] The statutes of Delaware, Nevada, Rhode Island, and Utah are similar to Alaska's in that they do not require a protective trust's assets to be located entirely in the state,[178] or to be administered solely by resident trustees.[179] Thus, a number of other states could have valid jurisdiction over the trustee of a Domestic Venue trust.

And despite any due process problems that may be present in not joining the trustee in an action that involves trust assets, there has been a general trend by both state and federal courts away from characterizing any party not present as "necessary" or "indispensable" since the revision of Federal Rule of Civil Procedure ("Federal Rule") 19 in 1966, which provides that parties who are subject to service of process should be joined "if feasible."[180] This approach gives courts more latitude to adjudicate disputes without joining additional parties. For example, the Texas Supreme Court, in *Cooper v. Texas Gulf Industries*,[181] said that "[i]t will be rare indeed if there were a person whose presence was so indispensable in the sense that his absence deprives the court of jurisdiction to adjudicate between the parties already joined." And in the fraudulent transfer context, the UFTA itself states that a judgment under that Act may be entered against either the transferee (*i.e.*, the trustee, whom the creditor may not be able to reach in a non-Domestic Venue jurisdiction) *or* against the person for whose benefit the transfer was made,[182] (*i.e.,* the grantor, who may reside in a non-Domestic Venue).

On the other hand, there is case law that has developed after the revision of Federal Rule 19 suggesting that the fraudulent transferee *is* a necessary party. These cases fall into three categories: (1) cases decided in states that have adopted a version of Federal Rule 19 and the decision is based upon that Rule,[183] (2) cases decided in states that have adopted a version of Federal Rule 19 but do not discuss that Rule at all,[184] and (3) cases decided in states that have not adopted a version of Federal Rule 19.[185] The one thing that these cases all have in common, though, is that the transferee was already subject to the deciding court's jurisdiction.[186] Because none of these cases involve a situation in which the transferee was not subject to service of process by the deciding court, they do not shed much light on whether the court, considering the more pragmatic approach of Federal Rule 19 and its state-rule counterparts, would still decide that the transferee is an indispensable party if that transferee were not within the court's jurisdiction.

Thus, because this issue still remains open, and because it is still quite likely that another state's court could enter a valid binding judgment affecting the assets of a Domestic Venue trust, an analysis of the full faith and credit vulnerabilities of the Domestic Venue legislation is called for.

[b] **Jurisdiction, Enforcement, and the Full Faith and Credit Clause.** As with any asset protection structure—foreign or domestic—the lawyer must probe for weaknesses by envisioning how the attack on the trust is likely to be played out. In many cases, an attack on an asset protection trust will be either the second phase of a lawsuit or a second suit entirely. The first action

will be the cause, cast in tort or contract, that gave rise to the liability, and will result in a judgment. The second phase of the creditor's attack will be a post-judgment enforcement proceeding, usually against the trust, in an effort to satisfy the judgment.

In order to pursue the trust assets in the first action, the creditor must proceed in a court that has jurisdiction over some aspect of the trust. If the trust is a Domestic Venue trust, this does not necessarily mean the Domestic Venue court. Another state's court may have jurisdiction over the trustee, the settlor, or the trust assets. A court could have jurisdiction over the trustee or settlor in a number of ways. First, individuals are always subject to the jurisdiction of courts within their domiciles.[187] Generally, this means that a non-Domestic Venue trustee or settlor is subject to the jurisdiction of his or her home state's courts. Jurisdiction may also exist under another state's long-arm statute if the trustee or settlor has sufficient contacts with the forum state.[188] Corporations are subject to the jurisdiction of the courts in the state of their incorporation.[189] They can also be subject to the jurisdiction of courts in any state in which they do business.[190] For large corporate trustees such as banks based, or with branches, in a Domestic Venue, this could give jurisdiction to the courts of many states. A state's courts will also have jurisdiction over all property within the state's borders.[191] This includes real property, bank and brokerage accounts, and shares of stock issued by corporations incorporated in that state.[192] If a trust holds stock in many different corporations, its property may be subject to the jurisdiction of several states' courts. Furthermore, any non-Domestic Venue activities in which the trust participates will likely involve the maintenance of accounts outside that state, which would become targets of creditors seeking to pursue their claims outside of the Domestic Venue courts.

For a judgment creditor to pursue trust assets in the second phase (the post-judgment enforcement action), the creditor must ultimately involve a court that has jurisdiction over the trust assets or over a party in control of the trust assets, which could likely be the Domestic Venue itself. As will be shown, because a judgment creditor who has obtained a favorable judgment in a non-Domestic Venue state against the assets of a Domestic Venue trust has the benefit of the full faith and credit clause of the U.S. Constitution, it is this post-judgment phase of the attack against an asset protection trust that obviates some of the protection the drafters of the Domestic Venue statutes intended to provide, and causes a Domestic Venue trust to be inferior to a foreign trust.

All state courts are bound by the Constitution and federal statutes to give full faith and credit to judgments rendered by the courts of sister states.[193] As long as the deciding court had proper jurisdiction and the judgment was not procured by fraud, the sister state court—including courts in Domestic Venues—must recognize the judgment and give it the full effect that it would have had if rendered by the sister state's court.[194] This rule applies even if the other state's court rendered its judgment based upon a misapprehension of Domestic Venue law, and even if the judgment was based upon a cause of action that would be against Domestic Venue law and public policy.[195] Furthermore, the Restatement of Judgments provides that a cause of action for money "merges" into the judgment and that a judgment for money by itself—the underlying cause of action having been resolved—cannot offend the public policy of a jurisdiction that simply is recognizing a judgment.[196] Thus, a creditor could procure a non-Domestic Venue judgment in a post-judgment enforcement proceeding against trust assets and present it to a Domestic Venue court. The Domestic Venue court would have no choice but to honor the judgment.[197] And if the sister state judgment by its terms gives the creditor ownership of specific trust assets located in Delaware, for example, Delaware's law will not protect the assets. That is because Domestic Venue courts are precluded by the full faith and credit clause from questioning the judgment itself, as discussed above. Therefore, if the judgment declares that a particular trust asset belongs to the creditor, an Alaska or Delaware court cannot revisit the issue. The court would have to accept that the asset did not belong to the trust and thus could not be considered exempt trust property—the court would be bound to order that the necessary steps be taken to turn that asset over to the creditor. This concept would also apply if a judgment of a court of a sister state court voided a transfer to a Domestic Venue trust under its own fraudulent transfer law or found the trust to be either a sham or the alter ego of the settlor. Domestic Venue courts would be forced to honor such a ruling and either order that the party in possession of the trust assets turn the assets over to the creditor or order that the trust assets be returned to, or be deemed to be held by, the settlor. If the court orders the latter, the creditor would then be able to reach the assets by suing in the debtor's state of domicile.

In sum, because of the full faith and credit clause, the assets of a Domestic Venue trust could be reached by a creditor who either never sets foot in the applicable state's courts or who appears in the situs state court on a *pro forma* basis to have the court enforce a judgment rendered by the court of another state. Foreign jurisdictions, on the other hand, are not bound by the Constitution to honor U.S. judgments; therefore, a creditor pursuing the assets of a foreign trust must bring an entirely new lawsuit in the foreign jurisdiction. This feature of a Domestic Venue trust alone significantly weakens its asset protection capabilities when compared to a foreign trust.

[c] **Supremacy Clause Concerns.** In some instances, a judgment creditor facing a judgment debtor who has been rendered "insolvent" due to a transfer to an asset protection trust will force the debtor into involuntary bankruptcy. In that case, the debtor will find himself under the jurisdiction of the United States Bankruptcy Court, which will apply federal bankruptcy law, and it is possible that the Constitution's supremacy clause[198] will come into play. The supremacy clause provides that "this Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." In short, the Bankruptcy Code takes precedence over any conflicting state law as a result of the supremacy clause.

Typically, a debtor will argue that Section 541(c)(2) of the Bankruptcy Code excludes from the bankruptcy estate his or her beneficial interest in a protective trust. Section 541(c)(2) states that a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law" is enforceable under the Bankruptcy Code. The debtor's position would be that the "applicable nonbankruptcy law" is that of the trust, not the debtor's domicile, and accordingly, the restrictions on the debtor-beneficiary's ability to transfer trust assets of an asset protection trust should be determined by looking to the law governing the trust.[199]

The creditor, on the other hand, could advance three arguments against the use of Domestic Venue law to determine whether the trust assets are exempt from creditors' claims. First, the creditor could contend that Section 541(c)(2) does not apply in the case of a Domestic Venue asset protection trust. To support this argument, the creditor could point out that the legislative history of Section 541(c)(2) indicates that it was intended to protect "spendthrift trusts"[200] in the traditional understanding of spendthrift trusts—which are trusts created by one party for the benefit of another party (not the settlor). The argument would assert that not only were Domestic Venue asset protection trusts not contemplated when Congress considered passing Section 541(c)(2), but they are not "spendthrift trusts" as understood by Congress at that time. Hence, prior to the passage of the Domestic Venue statutes, only trusts settled by someone other than the debtor could contain valid spendthrift provisions or other restrictions prohibiting hypothecation or alienation of trust assets that protect the debtor.

Second, a creditor could argue that the language of the new statutes that protects Domestic Venue trusts from creditors' claims is not a restriction on transfers within the meaning of Section 541(c)(2), but is in the nature of a state-law exemption.[201] In this case, the debtor would have to argue that the protection afforded Domestic Venue trusts by their statutes must be respected independently of Section 541(c)(2). But this argument would be successful only if made by a debtor domiciled in a Domestic Venue because Section 522(b)(2) of the Bankruptcy Code provides that the exemptions to be applied in bankruptcy are those of the debtor's domicile state, regardless of where the assets subject to the exemption are located.[202] Thus, unless the settlor is a domiciliary of the Domestic Venue, Section 522(b)(2) of the Bankruptcy Code would cause the debtor's home state laws, which lack an exemption for self-settled trusts, to apply. Therefore, the trust assets would be reachable by the creditor under the domiciliary state's rule against creditor protective self-settled trusts.

Finally, the creditor could plead in the alternative that, even if Section 541(c)(2) did apply, the "applicable nonbankruptcy law" should be determined by a "governmental interest" or "significant relationship" test, asserting that the interests of the debtor's domicile prevail over those of the Domestic Venue. Thus, the enforceability of transfer restrictions under Section 541(c)(2) should be determined under the domiciliary state's laws.[203]

[d] **Contract Clause Problems.** The Constitution prohibits states from enacting any law that impairs the "Obligation of Contracts."[204] This provision is known as the "contract clause," and was specifically intended by the framers to prevent the states from passing extensive debtor relief laws.[205] If a state law substantially impairs the obligations of parties to existing contracts or makes them unreasonably difficult to enforce, it will run afoul of the contract clause.[206] But the law will not be automatically void; instead it will be subjected to the "strict scrutiny" standard of review: to be valid, it must be narrowly tailored to promote a compelling governmental interest.[207]

A creditor could potentially argue that the Domestic Venue statutes violate the contract clause by eliminating the creditor's ability to seize assets to which he would otherwise have had access before the enactment of the statute. Even though the U.S. Supreme Court has, in the past, recognized a distinction between laws that regulate the substantive obligations of contracts and those that merely regulate the remedies for breach of those contracts, this distinction is no longer rigidly followed. Moreover, a creditor could argue that the new statutes do not affect only the remedies of the creditor, but they also alter the substantive obligations of the settlor-debtor. Because the settlor can potentially continue to use the assets that have been “discretionarily” distributed, the settlor’s enjoyment of the trust assets is not impaired, while the possibility of creditors reaching those assets is restricted. And because the debtor will not be harmed if he refuses to repay the debt, the debtor’s obligation to do so becomes illusory. While a full review of debtors’ potential arguments in defense of a contract clause violation is beyond the scope of this outline, one defense would be that fraudulent transfer laws offset the impairment of creditor/debtor contracts inherent in the Domestic Venue asset protection trust statutes by providing most creditors with a viable remedy when faced with a debtor who has transferred assets to avoid his repayment obligation.

[e] **Constitutional Arguments in Perspective.** The foregoing sections have described three potential U.S. Constitutional arguments a judgment creditor might advance when faced with the challenge of reaching assets of a Domestic Venue asset protection trust to satisfy his or her judgment. Note that a creditor would have *no* U.S. Constitutional arguments to advance if dealing with a foreign asset protection trust. In the analysis of the U.S. Constitutional arguments with regard to Domestic Venue trusts, however, it is important to keep the *effect* of such arguments in perspective.

The effect of a “full faith and credit” argument is to weaken the Domestic Venue statutes by permitting judgments rendered under the laws of jurisdictions outside of the Domestic Venues to be enforced against assets of Domestic Venue asset protection trusts in spite of the fact that such judgment might not have been rendered under Domestic Venue law. It should also be noted that full faith and credit does not help debtors force the application of Domestic Venue law in other states. That issue is resolved under conflicts of laws principles.[208]

The effect of a successful contract clause claim, unlike the effect of a full faith and credit claim, would be to invalidate the part of the statute that impairs contracts (*i.e.*, the protection of discretionary beneficial interests in self-settled trusts from the claims of settlors’ creditors). Even though a contract clause argument would undoubtedly be hard fought, the contract clause argument is probably the only viable Constitutional claim that could potentially obliterate the Domestic Venue asset protection trust laws.

Finally, the supremacy clause argument has yet another effect. Applicable in this case only in the bankruptcy context, the supremacy clause dictates that the provision of the bankruptcy code requiring exemption laws of the settlor's domicile to be applied reigns supreme. Accordingly, assuming a creditor could convince a bankruptcy court that the exemption for beneficial interests in trusts under Section 541(c)(2) should not protect assets of Domestic Venue asset protection trusts, it is possible that only Domestic Venue domiciliaries would benefit from the new laws in the bankruptcy context. Unlike the weakening or invalidating effect, respectively, of the full faith and credit and contract clause arguments, the supremacy clause has the effect of narrowing the possible class of persons who might benefit from the new statute.

3. Domestic Asset Protection Trust Legislation: Conclusion. Recent amendments to these laws show that the Domestic Venue legislators are still working on weaknesses in the statutes themselves. But regardless of how perfectly the legislators may be able to draft these statues, a number of arguments remain available to creditors attempting to reach the assets of a Domestic Venue trust. And a major barrier to the entry of the Domestic Venues into the asset protection arena exists due to the fact that they are all part of the United States, and are thus subject to the U.S. Constitution. Domestic Venues are unable to bring their laws in line with the more aggressive asset protection laws in some offshore jurisdictions, because to do so would violate constitutional mandates. Quite simply, their statehood prevents them from being able to fully control a creditor's right to obtain and enforce judgments against trust assets. Therefore, a settlor who is contemplating choosing a Domestic Venue as the jurisdiction for an asset protection trust must realize that a stateside trust cannot protect assets as well as a trust in an offshore jurisdiction. Although there may be other reasons for locating an asset protection trust in a Domestic Venue,[209] those states cannot match offshore jurisdictions when it comes to sheltering trust assets from the claims of creditors.

D. Other Emerging Domestic Trends.

1. Foreign Capital Depository Acts. Financial privacy is an important and legitimate goal in asset protection planning. For instance, wealthy individuals can be targets of crimes or frivolous lawsuits when their fiscal information is readily available. But even though U.S. citizens expect privacy as a fundamental right, financial confidentiality is difficult to achieve in domestic venues. Many offshore jurisdictions offer banking privacy to U.S. citizens that they can't get at home. Unfortunately, this heightened privacy might also attract individuals wishing to hide their illegal activities from the U.S. government, which has led to federal initiatives that have stripped Americans of practically all confidentiality when it comes to financial transactions.[210]

The Montana Foreign Capital Depository Act[211] and the Colorado Foreign Capital Depository Act[212] are good examples of state governments addressing the reality of financial crimes at the local level while allowing privacy for bank customers. These Acts allow foreign persons or entities to charter a depository that may have accounts from individuals who are not citizens or residents of the U.S. or from entities or trusts whose shareholders, settlors, members, beneficiaries, or partners are not citizens or residents of the U.S. As a promotional tool, these Acts prohibit disclosure of financial records unless illicit activity is suspected. To protect against money laundering, they require depository institutions to implement "know your customer" policies and security measures "to prevent theft, fraud, and corruption."[213] More importantly, however, the Acts reflect the desire of U.S. jurisdictions to attract foreign investors by offering "a prudent blend of financial privacy, asset protection, and profitability."[214]

Montana senator Michael Sprague has predicted that the depositories could bring in up to $1 billion in annual revenues to the state of Montana. This was thought to not be a difficult goal to reach in Montana with plenty of foreign investors eager to deposit the minimum $200,000 to the depositories. Each depository is required to pay a $50,000 license fee to the Montana Commerce Department, a $10,000 annual charge, and a tax equal to 1.5% of deposits (derived from fees charged depositors.)[215] However, to date, Montana has yet to charter a foreign capital depository.

2. States Repealing the Rule Against Perpetuities. In an attempt to allow assets to stay in trust longer, some states have either repealed the Rule Against Perpetuities altogether, have exempted certain trusts, or have allowed a trust instrument to expressly state that the Rule Against Perpetuities does not apply. Many states have not altogether eliminated the Rule Against Perpetuities, but have instead extended the common law Rule. (For a summary of the states' various laws concerning the Rule Against Perpetuities, see the chart attached as Exhibit B.)

1. 11 U.S.C. §541.

2. It should be noted that a creditor does not have to choose between pursuing a debtor under state fraudulent transfer law or under federal bankruptcy law. However, a state fraudulent transfer claim would probably be the easier of the two for a creditor to pursue.

3. *Mareva Compania Naviera, S.A. v. International Bulkcarriers, S.A.,* 2 Lloyd's Rep. 509 (1975).

4. *See*, *e.g.*, *U.S. v. Levine et. al.*, 951 F.2d 1466 (6th Cir. 1991) (Mr. Levine had an account at a branch of a Swiss bank in the Bahamas, and despite Bahamas bank secrecy laws, U.S. authorities gained access to information about the account by exerting pressure on the U.S. branch of the Swiss bank).

5. *See, e.g., British Overseas Territories Report,* Secretary of State for Foreign and Commonwealth Affairs, Partnership for Progress and Prosperity, British Overseas Territory, March 1999.

6. *See* M. Langer, *Practical Int'l Tax Planning* (3rd Ed. 1990) at ch. 20 (discussing "Operation Tradewinds" and "Project Haven," IRS investigations conducted using arguably questionable methods).

7. Bahamas Business License Act (No. 8 of 1980).

8. Gibson, "Revamping Trust Legislation-The Bahamian Story," *Offshore Investment* (July/August 1998) at 8.

9. *Id.*

10. *Id.*

11. *Grupo Torras, S.A. v. S.F.M. Al-Sabah, et. al,* 1 Lloyd's Rep. 7 (Eng.C.A.1995).

12. Bermuda Government, Office of the Tax Commissioner

13. Bermuda Exempted Undertakings Tax Protection Act (1966).

14. *See* Section 45(1) of the Bankruptcy Act 1989; Section 36 of the Conveyancing Act 1983; Section 47(1) of the Bankruptcy Act 1989 (fraudulent preferences); Section 41 of the Matrimonial Causes Act 1974; and Section 21 of the Succession Act 1974.

15. *See* The Confidential Relationships (Preservation) Law, 1976, as amended in 1979.

16. Compare the Bahamas statute of limitation of two years.

17. STAR Section 3.

18. STAR Section 2(1).

19. The Perpetuities (Amendment) Law 1997.

20. The interlocutory judgment of the Cook Islands High Court illuminates the current tension in the Cook Islands between its secrecy laws and the necessity for discovery and is attached as Exhibit C.

21. *515 South Orange Grove Owners, et al., v. Orange Grove Partners,* Plaint No. 208/94, High Court of the Cook Islands (Civ.Div.) (CA 1/95 and CA 31/96).

22. *See* The Bankruptcy (Amendment) Ordinance, 1990.

23. IM Tax Act of 1970 (as amended), §1.

24. *The Edwards Report,* published by the Stationery Office Limited and is available from the Publications Centre, P.O. Box 276, London, SW8 5DT, England.

25. Trustee Act 2001, Part 6, Paragraph 38.

26. There may be some attempt at erosion of this concept as a result of the changes suggested by *The Edwards Report, Id.*

27. *Tournier v. National Provincial and Union Bank of England*, 1 KB 461 (1924).

28. Comptroller of Income Tax, "Concession and Practice" (February 2000), Concess 1.

29. Income Tax (Jersey) Law 1961, Art 11 and First Schedule.

30. *Golder v. Société des Magasins Concorde Limited* [1967] JJ 721; see also *Grupo Torras S.A.. v. S.F.M. Al Sabah et. al* (2001) (in which the Royal Court [Samedi Division] refused to allow a distribution out of the trust to the settlor for purposes of reducing his debt).

31. Bankruptcy (*Désastre*) (Jersey) Law 1990, Art 17.

32. Trusts (Jersey) Law, 1984, Art. 2.

33. *Id.*, Art. 1(1).

34. *Id.*, Art. 45.

35. *Id.*, Art. 52.

36. *Id.*, Art. 50(4).

37. *Id.*, Art. 51.

38. *Id.*, Art. 53.

39. *Id.*, Art. 10(1).

40. *Id.*, Art. 9(1).

41. *Id.*, Art. 9(2).

42. *Id.*, Art. 9(4)-9.

43. *Id.*, Arts. 8, 10(2)(a)(iii).

44. Nevis Int'l Exempt Trust Ordinance § 43; Nevis Bus. Corp. Ordinance § 123(1); and Nevis Ltd. Liab. Co. Ordinance §83(2).

45. Fiscal Incentives Act (No. 17 of 1974).

46. 13 Eliz. Ch 5 (1571).

47. Nevis Int'l Exempt Trust Ordinance §49.

48. *Id.*, §24(1)(a).

49. *Id.*, §24(1)(b).

50. *Id.*, §24(2).

51. *Id.*, §24(10).

52. *Id.*, §24(9).

53. Nevis Ltd. Liab. Co. Ordinance §19.

54. *Id.*, §13.

55. *Id.*, §43.

56. *Id.*, §§40(4), 41; *see* IRC §2704(b).

57. Such an entity could elect to be disregarded for U.S. tax purposes.

58. The following discussion is based on Elizabeth M. Schurig and Amy P. Jetel, "A Closer Look at U.S. Asset Protection Trusts," Ch. 5, *Asset Protection Strategies Vol. II*, Alexander A. Bove, Jr., ed.

59. In 1986, Missouri amended its spendthrift trust statute in a way which might permit creation of asset protection trusts, but the statute was not specifically drafted or clearly amended with this purpose in mind.

60. UFTA §4(b).

61. UFTA §4(a)(2).

62. UFTA §4(a)(1).

63. *Id*.

64. UFTA §4(b)(1)-(11).

65. *Id.*

66. UFTA §5(a).

67. UFTA §2.

68. UFTA §5(b).

69. UFTA §1(7)(i).

70. UFTA §9(a).

71. UFTA §9(b).

72. UFTA §9(c).

73. *See* UFTA §8(f).

74. AK ST §13.36.105-220; AK ST §13.36.310; AK ST §34.40.110.

75. AK ST §34.40.010 *et seq*.

76. AK ST §34.40.110(b).

77. UFTA §4(a)(1).

78. AK ST §34.40.110(j). In the estate tax context, because this new provision, like the Delaware statue, makes implied agreements void as a matter of law, it could eliminate an argument by the IRS that the settlor retained the use and enjoyment of the assets under IRC §2036 due to an implied agreement, and the trust assets should thus be included in the settlor's gross estate. In the gift tax context, this provision supports an argument all transfers to Alaska (and possibly Delaware) asset protection trusts are always completed gifts; see, for example PLR 9837007, in which the IRS based its finding that a transfer to an Alaska trust was a completed gift on the taxpayer's "representation that there is no express or implied agreement between the Donor and the Trustee as to how the Trustee will exercise its sole and absolute discretion to pay income and principal among the beneficiaries."

79. Del. Code Ann. tit. 12, §3571.

80. AK ST §34.40.110(b)(3).

81. AK ST §34.40.110(k).

82. AK ST §34.40.010.

83. AK ST §34.40.110(d).

84. *See, e.g., Pattee v. Pattee,* 744 P.2d 658 (Alaska 1987) (overruled on other grounds); *Sylvester v. Sylvester,* 723 P.2d 1253 (Alaska 1986); *Gabaig v. Gabaig,* 717 P.2d 835 (Alaska 1986); *First Nat'l Bank of Fairbanks v. Enzler,* 537 P.2d 517 (Alaska 1975).

85. *Sylvester,* 723 P.2d 1253 (Alaska 1986); *First Nat'l Bank of Fairbanks*, 537 P.2d 517 (Alaska 1975).

86. It can be argued that the Alaska law renders this badge of fraud inapplicable to Alaska trusts because it states that no trust or transfer is void or voidable because it "avoids or defeats a right, claim, or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of marital or similar right." AK ST §13.36.310. However, the language "hinder or delay creditor recovery" is so broad that the statutory protection would be strengthened if §13.36.310 were revised to specifically make this badge of fraud inapplicable.

87. *First Nat'l Bank of Fairbanks,* 537 P.2d 517 (Alaska 1975).

88. Uniform Fraudulent Transfer Act, §4(b)(1) (1984).

89. *Gabaig,* 717 P.2d at 839.

90. AK ST §09.10.040.

91. *Uniform Foreign Money Judgments Recognition Act,* 13 U.L.A. 261, §3. *See* AK ST §09.30.100 *et. seq.*

92. In contrast, both Massachusetts and Texas have amended their versions of the Uniform Act to require reciprocity.

93. AK ST §09.60.010; Ak.R.C.P. 82.

94. *Lee Houston & Assoc., Ltd. v. Racine,* 806 P.2d 848, 856 (Alaska 1991).

95. *Id.*

96. Del. Code Ann. tit. 12, §3570 *et seq.*

97. Del. Code Ann. tit. 12, §3570(10)(d).

98. Del. Code Ann. tit. 12, §3570.

99. Del. Code Ann. tit. 12, §3571 and §3572.

100. Del. Code Ann. tit. 12, §3573.

101. Del. Code Ann. tit. 12 §3572(g).

102. *Id*.

103. 2003 Delaware Laws Ch. 100, Section 6 (HB 193).

104. U.S. Const., Art. IV, Sec. 1.

105. *Shaffer v. Heitner*, 97 S.Ct. 2569 (1977); *see also Green v. Van Buskirk,* 72 U.S. 307 (1866); 74 U.S. 139 (1868).

106. See note at 109, *infra*.

107. Del. Code Ann. tit. 6, §1301 *et seq.*

108. Del. Code Ann. tit. 12, §3572(b); this limitation applies "notwithstanding the provisions of" the UFTA.

109. UFTA §9(a).

110. Del. Code Ann. tit. 12, §3570(8).

111. Del. Code Ann. tit. 12, §3572(c).

112. Del. Code Ann. tit. 12, §3572.

113. *Mitchell v. Wilmington Trust Co.,* 449 A.2d 1055 (Del. Ch. 1982), *aff'd,* 461 A.2d 696 (Del. 1983); *United States v. West,* 299 F. Supp. 661 (D. Del. 1969).

114. Del. Code Ann. tit. 12, § 3572.

115. Del. Code Ann. tit 12, §3572(e).

116. U.S. Const., Art. IV, Sec. 1.

117. *McElmoyle, for Use of Bailey v. Cohen*, 38 U.S. 312 (1839); *Matanuska Valley Lines, Inc., v. Molitor*, 365 F.2d 358 (9th Cir. 1966).

118. *See, e.g.,* Richard G. Bacon & John A. Terrill, II, *Domestic Asset Protection Trusts Work—Should They?* 2000 Annual Meeting, The American College of Trust and Estate Counsel, March 3-7, 2000

119. Del. Code Ann. tit. 12, §3572.

120. UFTA §8(b).

121. Del. Code Ann. tit. 10, §4801.

122. Del. Code Ann. tit. 10, §5101.

123. Del. R. Super. Ct. RCP Rule 54.

124. *See, e.g., Pierce v. International Insurance Company of Illinois*, 671 A.2d 1361 (Del. 1996); *Jardel Co., Inc., v. Hughes*, 523 A.2d 518 (Del. 1986).

125. Nev. Rev. Stat. §166.040.

126. Nev. Rev. Stat. §166.170.

127. Nev. Rev. Stat. §11.190.

128. Nev. Rev. Stat. §18.010.

129. Nev. Rev. Stat §18.010(b)(2).

130. Nev. Rev. Stat §42.005.

131. RI ST §18-9.2-1 *et seq*.

132. RI ST §9-1-17.

133. RI ST §9-22-5.

134. *DiIorio v. Cantone*, 49 R.I. 452, 144 A. 148 (1929).

135. *Greater Providence Deposit Corp. v. Jenison*, 485 A.2d 1242 (R.I. 1984).

136. *Sherman v. McDermott*, 329 A.2d 195 (R.I. 1974).

137. *Scully v. Matarese*, 422 A.2d 740 (R.I. 1980).

138. UT ST §25-6-14(2)(c).

139. UT ST §7-5-1.

140. UT ST §25-6-14(1)(c).

141. UT ST §25-6-1 et seq. The new trust legislation is contained in a new section 25-6-14 of Utah's UFTA.

142. UT ST §25-6-14(2)(c)(i).

143. UT ST §25-6-5(2).

144. UT ST §25-6-14(2)(c)(v).

145. UFTA §4(a)(2); UT ST §25-6-5(b).

146. UT ST § 25-6-14(4).

147. UT ST §25-6-14(5)(a).

148. UT ST §25-6-14(5)(b).

149. UT ST §25-6-14(3).

150. UT ST §78-12-22.

151. UT ST §78-27-56.

152. *See Macris & Associates, Inc. v. Neways, Inc.*, 16 P3d 1214 (Utah, 2000); *Despain v. Despain*, 682 P.2d 849 (Utah, 1984).

153. *See In re Brooks*, 217 B.R. 98 (Bankr. E.D. Conn. 1998) (on grounds of public policy, court applied Connecticut law to determine the enforceability of spendthrift provisions of self-settled Jersey and Bermuda trusts; *held*, spendthrift provisions were unenforceable and trust assets therefore were property of the bankruptcy estate.)

154. Nev. Rev. Stat. §166.040; RI ST §18-9.2-4; UT ST §25-6-14(2)(c)(iii).

155. AK ST §34.40.110(j); Del. Code Ann. tit. 12, §3571.

156. *See, e.g., Scott on Trusts,* §626(c) (4th ed. 1989); *First Nat'l. Bank v. National Broadway Bank,* 156 N.Y. 459, 51 N.E. 398 (1898).

157. With regard to trusts, *see, e.g., In re Brooks*, 217 B.R. 98 (Bankr. E.D. Conn. 1998); *In re Larry Portnoy,* 201 B.R. 685 (Bankr. S.D.N.Y. 1996); *First Nat'l Bank in Mitchell v. Dagget*, 497 N.W.2d 358 (Neb. 1993). With regard to the general principle that foreign law will not be used if it contravenes the forum state's public policy, *see, e.g., Loucks v. Standard Oil Co,* 120 N.E. 198 (N.Y. 1918) (Cardozo, J.); *see, generally,* Scoles and Hay, *Conflict of Laws*, §3.15 *et. seq*. (2d ed. 1993).

158. All states that have dealt with this issue have declared, either by statute or case law, that spendthrift provisions in self-settled trusts are void against existing creditors and that a wholly discretionary interest retained by the settlor will be interpreted in light of the trustee's discretionary authority to distribute *all* trust assets, thereby allowing creditors complete access to them. *See, e.g.,* Duncan E. Osborne and Elizabeth M. Schurig, *Asset Protection: Domestic and International Law and Tactics,* Ch. 14 (four volumes, West Group, updated quarterly, 1995). For example, in Texas, "[p]ublic policy does not countenance devices by which one frees his own property from liability for his debts, or restricts his power of alienation of it; and it is accordingly universally recognized that one cannot settle upon himself a spendthrift or other protective trust, or purchase such a trust from another, which will be effective to protect either the income or the corpus against the claims of his creditors, or to free it from his own power of alienation. The rule applies in respect of both present and future creditors and irrespective of any fraudulent intent in the settlement or purchase of a trust." *In re Shurley*, 115 F.3d 333 (5th Cir. 1997), citing *Glass v. Carpenter,* 330 S.W.2d 530, 533 (Tex.Civ.App. - San Antonio 1959, writ ref'd n.r.e). The Second Circuit, Seventh Circuit, and Tax Court have read the laws of New York, Indiana, and Maryland, respectively, to say that a settlor's discretionary right to income is not reachable by his or her creditors, but no state court has concurred with this conclusion. Furthermore, commentators have correctly noted that settlors have not chosen to rely on the circuit courts' interpretation. *See, e.g.,* Hompesch, Rothschild, and Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" 2 *J. of Asset Prot.* No. 9 (July/Aug 1997). Missouri Revised Statutes §456.080 has been interpreted to allow creditor-proof discretionary trusts, but, again, settlors have not chosen to rely on this interpretation. Missouri courts have traditionally disallowed creditor protection for self-settled trusts, and the local bankruptcy court has specifically declared that the statute does not change the "existing" rule prohibiting self-settled creditor protective trusts. *In re Enfield,* 133 B.R. 515 (Bankr. E.D. Mo. 1991).

159. *See In re Brooks*, 217 B.R. 98 (Bankr. E.D. Conn. 1998). Another dispute in which a court might choose to apply the law of the debtor's domicile, and not Alaska or Delaware law, is in the context of a community property claim. In the states that have adopted a community property system of marital property ownership (*e.g.,* California, Texas, New Mexico), with few exceptions, all property acquired during a marriage belongs equally to both spouses, regardless of which spouse actually earned it. Thus, the validity of a claim against trust assets made by the spouse of a settlor domiciled in a community property state would have to be decided under the law of the settlor's domicile, even in an Alaska court. For example, although the Alaska statute provides that no trust or transfer is void or voidable because it "avoids or defeats a right, claim, or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of marital or similar right" (AK ST §13.36.310), to the extent it deprives the settlor's spouse of property

rights that had vested in a community property state, it is arguable that this statute violates substantive due process. Any conveyance to a trust made with the intent to deprive the spouse of her community interest would be fraudulent, and it is unlikely that the courts would defer to the Domestic Venue's economic interest in maintaining a haven for fraudulently funded trusts.

160. *See SEC v. Bilzerian* 112 F. Supp. 2d 12 (D.C. Cir. 2000); *See also Johnston v. Commissioner*, T.C. Memo 2000-315. *Cf*. *Alsop v. Commissioner*, T.C. Memo 1999-172 (finding no *intention* to create a valid trust, but labeling it as a "sham trust.")

161. *See In re Gillespie,* 269 B.R. 383 (Bkrtcy. E.D. Ark., 2001)*; Cohen v. United States*, 1998 WL 953979 (D. Cal. 1998, unreported); *But see In re Vebeliunas,* 252 B.R. 878 (Bkrtcy. S.D.N.Y., 2000) and *Wilshire Credit Corp. v. Karlin*, 988 F.Supp. 570 (D. Mass. 1997) in which the corporate "alter ego" theory is rightly rejected by the courts as applying to trusts.

162. For example, offshore trust jurisdictions generally are not parties to the Hague Convention on the Taking of Evidence Abroad on Civil or Commercial Matters.

163. *Restatement 2d, Conflict of Laws,* §132 (1971).

164. *Id.*

165. 179 F.3d 1228 (9th Cir. 1999).

166. *See In Re Stephan Jay Lawrence*, 279 F.3d 1294 (CA 11th Cir 2002) and *SEC v. Bilzerian*, 264 B.R. 726 (Bankr.M.D.Fla., 2001); see also *Chadwick v. Janecka*, 312 F.3d 597 (CA 3rd Cir 2002) (Court found that 7 years incarceration for contempt not unconstitutional when debtor is able to pay judgment but refuses to do so).

167. *U.S. v. Rylander*, 460 U.S. 752, 757 (1983) ("Where compliance is impossible, neither the moving party nor the court has any reason to proceed with the civil contempt action. It is settled, however, that in raising this defense, the defendant has a burden of production.")

168. *SEC v. Bilzerian*, 112 F. Supp. 2d 12, 28 (D.C. Cir. 2000); *see also American Insurance Company v. Coker*, 251 B.R. 902, 905 ("Debtors' proposed defense of impossibility is invalid in that the law does not recognize the defense of impossibility when the impossibility is self created").

169. *U.S. Const.,* Art. IV, Sec. 1.

170. *U.S. Const.,* Art. I, Sec. 10.

171. *U.S. Const.,* Art. VI, Sec. 2.

172. U.S.C.A. Const. Amend. 14; *see Sniadach v. Family Finance Corp.*, 89 S.Ct. 1820 (1969); *Tanaka v. Nagata*, 868 P.2d 450 (Hawai'i, 1994); *see also Reception of the Uniform Fraudulent Transfer Act*, 43 S.C.L.Rev. 655, 673 (1992).

173. *See, e.g., Becker v. Becker*, 416 A.2d 156, 162 (Vermont, 1980).

174. *International Shoe Co. v. Washington,* 326 U.S. 310 (1945).

175. *Shaffer v. Heitner*, 97 S.Ct. 2569 (1977).

176. AK ST §13.36.320(a).

177. AK ST §13.36.035(c)(1).

178. With regard to the trust assets, see Del. Code Ann. tit. 12, §3570(9)(b); Nev. Rev. Stat. §166.015(1); RI ST §18-9.2-2(8)(ii) UT ST §75-7-208(3)(a).

179. With regard to trustees, see Del. Code Ann. tit. 12, §3570(9)(a); Nev. Rev. Stat. §166.015(2); RI ST §18-9.2-2(8)(i); UT ST §7-5-1(1)(d)(ii).

180. *See, e.g.*, Fed.R.C.P. 19 (Federal Courts); C.C.P. §389 (California); CPLR §1001(b) (New York); Tex.R.C.P. 39 (Texas). A majority of the states have adopted Fed.R.C.P. 19 in some form.

181. 513 S.W.2d 200, 204 (Tex. 1974)

182. UFTA §8(b).

183. *Sylvester*, 723 P.2d 1253 (Alaska, 1986); *Friedman v. Friedman* 509 N.Y.S.2d 617 (New York, 1986); *Becker v. Becker*, 416 A.2d 156 (Vermont, 1980); *Murray v. Murray*, 358 So.2d 723 (Mississippi, 1978); *Johnson v. Johnson*, 572 P.2d 925 (Nevada, 1977);

184. *Dempsey & Spring, P.C. v. Ramsay*, 435 N.Y.S.2d 336 (New York, 1981);

185. *Mihajlovski v. Elfakir,* 355 N.W.2d 264 (Michigan, 1984); *Elmore v. Elmore*, 557 S.W.2d 910 (Missouri, 1977); *Guice v Modica*, 337 So.2d 302 (Louisiana, 1976).

186. Federal Rule 19 requires that a party first be subject to service of process and that their joinder not deprive the court of jurisdiction over the subject matter of the action before a determination can be made as to whether it's feasible that they be joined.

187. *See, e.g.*, *Milliken v. Meyer,* 311 U.S. 457 (1940).

188. *International Shoe Co.,* 326 U.S. 310 (1945); *Shaffer*, 97 S.Ct. 2569 (1977).

189. *Restatement 2d, Conflict of Laws,* §41 (1971).

190. *See, e.g., International Shoe Co.,* 326 U.S. 310 (1945); *Gulf Oil Corp. v. Gilbert,* 330 U.S. 501 (1947).

191. *See, e.g., Green v. Van Buskirk,* 72 U.S. 307 (1866); 74 U.S. 139 (1868).

192. *Id.*

193. *U.S. Const.,* Art. IV, Sec. 1.

194. *See* Scoles & Hay*, Conflict of Laws*, 2d ed. (1992), at 968-986.

195. *See, e.g., Restatement 2d, Judgments* §17 (1982); *Fauntleroy v. Lum*, 210 U.S. 230, 237 (1908).

196. *Restatement 2d, Judgments* §17, 18 (1982).

197. Domestic Venue courts would also be required to honor a judgment that trust assets are community property and that, therefore, a portion of those assets is not the property of the settlor, but rather is the property of his or her spouse.

198. U.S. Const., Art. VI, Sec. 2.

199. *See, e.g., In re Remington,* 14 B.R. 496 (Bankr. NJ 1981) (court held that Pennsylvania law [the law of the trust] applies to determine extent of New Jersey debtor's right to trust assets).

200. *See* HR Rep. No. 595, 95th Cong., 1st Sess. 369 (1977).

201. The Alaska statute, for example, simply denies creditor access to self-settled discretionary trusts. Unlike certain other states' laws (*e.g.,* Delaware), it does not statutorily confer "spendthrift trust" status on such trusts.

202. United States Bankruptcy Code, 11 U.S.C. §522(b)(2).

203. *See, e.g., In re Larry Portnoy,* 201 B.R. 685 (Bankr. S.D.N.Y. 1996) (holding that New York law should determine debtor's rights in a Jersey (Channel Islands) trust because "the trust, the beneficiaries, and the ramifications of [debtor's] assets being transferred in to the trust have their most significant impact in the United States . . . and that application of Jersey's substantive law would offend strong New York and federal bankruptcy policies."). This second argument is similar

to the argument a creditor might advance in a non-bankruptcy context to convince a court not to apply the governing law of the trust.

204. *U.S.Const.*, Art I, Sec. 10.

205. Wright, *The Growth of American Constitutional Law* 64 (1967); *Home Building & Loan Assoc. v. Blaisdell,* 290 U.S. 398, 427-428 (1934) (Hughes, J. discussing historical background of the contract clause).

206. Wright, *The Contract Clause of the Constitution* (1938); Nowak and Rotunda, *Constitutional Law,* at 11.8 (5th Ed. 1995).

207. The U.S. Supreme Court first used the contract clause to invalidate a state law on the basis of unreasonable interference with contracts in *Fletcher v. Peck*, 10 U.S. 87 (1810). The Court continued to use the clause for this purpose throughout the nineteenth century. *See, e.g., Sturges v. Crowninshield*, 17 U.S. 122 (1819); *Ogden v. Saunders*, 25 U.S. 213 (1827); *Bronson v. Kinzie*, 42 U.S. 311 (1843). However, the clause fell into obscurity during the Court's "substantive due process" era, because "substantive due process" gave the Court greater discretion in passing on the constitutionality of state legislation. Thereafter, the contract clause was considered of little or no importance until its revival in 1977 in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977). The next year, it was used by the Court to invalidate a statute for unreasonable interference with private contracts in *Allied Structural Steel v. Spannaus*, 438 U.S. 234 (1978), and the Court has continued to use a contract clause analysis for this purpose. *See, e.g., Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983); *Energy Reserves Group, Inc. v. Kansas Power & Light Co*., 459 U.S. 400 (1983); *Keystone Bituminous Coal Assoc. v. DeBenedictis*, 480 U.S. 470 (1987); *General Motors Corp. v. Romein*, 503 U.S. 181 (1992).

208. *See* Hompesch, Rothschild, and Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" 2 *J. of Asset Prot.* No. 9 (July/Aug 1997) at 12-14.

209. One reason would be transfer tax planning. For a discussion of possible planning opportunities, *see* Blattmachr, Blattmachr, and Rivlin, "A New Direction in Estate Planning: North to Alaska," *Trusts & Estates*, September 1997.

210. *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act; see also* the *Gatekeeper Initiative* proposed by the U.S.-led working group of the Financial Action Task Force (FATF).

211. MT ST §32-8-101 *et seq*.

212. COLO REV STAT §11-37.5-101 (1999).

213. MT ST §32-8-301.

214. MT ST §32-8-102.

215. Brigid McMenamin, "Rocky Mountain High," *Forbes*, November 3, 1997.

EXHIBIT A

Version February 10, 2003

Agreement

on the Swiss banks' code of conduct with regard to the exercise of due diligence (CDB 03)

between

The Swiss Bankers Association

on the one hand

and

The signatory banks
(hereinafter "the banks")

on the other hand

of December 2, 2002

Introduction

Art. 1 Preamble

- **With a view to preserving the good name of the Swiss banking community, nationally and internationally,**
- **with a view to establishing rules ensuring, in the area of banking secrecy and when entering into business relations, business conduct that is beyond reproach,**
- **with an effort to provide effective assistance in the fight against money laundering and against financing acts of terrorism,**

the banks hereby contract with the Swiss Bankers Association in its capacity as the professional body charged with safeguarding the interests and reputation of Swiss banking:

a) to verify the identity of their contracting partners and, in cases of doubt, to obtain from the contracting partner a declaration setting forth the identity of the beneficial owner of assets;

b) not to provide any active assistance in the flight of capital;

c) not to provide any active assistance in cases of tax evasion or similar acts, by delivering incomplete or misleading attestations.

1 [1]This agreement applies to the signatory banks and all their branches located in Switzerland, but not to their foreign branches, representative offices and subsidiary companies (cf., however, points 11, 19 and 21).

[2]The banks may, however, not misuse their foreign branches and group companies engaging in banking and finance to circumvent this agreement.

2 This agreement in no way modifies the obligation to observe banking confidentiality. It cannot and is not intended to

- extend to Swiss territory the area of application of foreign legislation in economic, fiscal and currency matters, or declare such legislation to be applicable to Swiss banks (unless this is already provided for under current international treaties and Swiss law);

- depart from current legal practice in the field of international law;
- modify provisions under civil law governing relations between banks and their customers.

3 This agreement lays down, with binding effect, valid rules of good conduct in bank management as a code of professional ethics. They should put in concrete terms certain points of due diligence governed by the Anti Money Laundering Act (art. 3 through 5 of the AMLA) and "the diligence that can be reasonably expected under the circumstances" (art. 305^{ter} of the Swiss Penal Code) [1]. Special due diligence rules for business relations and transactions involving higher risks are set forth in the Anti Money Laundering Ordinance by the Swiss Federal Banking Commission. - This is not intended to impede normal banking business.

[1] Separate regulations govern the analogous application of the CDB to the business practice of credit card companies.

A VERIFICATION OF THE CONTRACTING PARTNER'S IDENTITY AND DECLARATION OF IDENTITY OF THE BENEFICIAL OWNER

Art. 2 Verification of the contracting partner's identity

[1]The banks undertake to verify the identity of the contracting partner when establishing business relations with said partner.

[2]This regulation applies to:

- **opening of accounts or passbooks;**
- **opening of securities accounts;**
- **entering into fiduciary transactions;**
- **renting of safe-deposit boxes;**
- **entering into management agreements for assets deposited with third parties;**
- **the execution of transactions with securities, currencies as well as precious metals and other commodities exceeding the amount of CHF 25,000.**
- **cash transactions exceeding the amount of CHF 25,000.**

I. Scope of application

4 The obligation to verify identity is valid, subject to point 18, regardless of whether the accounts, passbooks and securities accounts of any kind whatsoever, or the safe-deposit boxes, are maintained under the name of the contracting partner or under a number (art. 9).

5 In the case of bearer savings books, the bank must verify the identity of any persons who deposit or withdraw amounts exceeding CHF 25,000. New bearer savings books must not be opened.

6 Securities are deemed to be standardized securities suitable to be traded in large quantities, non-certificated stocks of equal function (inscribed stocks) and derivatives (cf. art. 2 lit. a of the Swiss Stock Exchange Act). This definition also subsumes non-standardized financial products.

7 Cash transactions refer to transactions carried out at a bank's teller window (currency exchange, purchase and sale of precious metals, cash subscriptions to bank 'cash bonds' and debenture loans, cash sale of travellers checks, cashing of checks, etc.). Cash deposits into and cash withdrawals from as well as the delivery of securities into or out of existing accounts/passbooks are not deemed cash transactions (subject to point 5).

8 [1]The bank shall verify the identity of the contracting partner when entering into transactions below the minimum limit (art. 2, par. 2, 6 and 7 lemma) if it is obvious that the transaction has been split up with the purpose of avoiding verification of identity (so-called “smurfing”).

[2]If the bank has cause to suspect that the assets originate from sources described in art. 9 par. 1 of the AMLA, it has to verify the identity of the contracting partner, regardless of minimum limits (art. 2, par. 2, 6 and 7 lemma) or exceptions to formal identification (point 18 of this agreement). This is not applicable if the bank declines to carry out the transaction for or to enter into a business relation with said contracting partner.

II. Verification of the contracting partner's identity

1. Individuals

a) In the case of personal negotiations between the party concerned and the bank

9 When the party concerned personally enters into negotiations with the bank, the bank verifies the identity of the contracting partner by examining and making a photocopy of an official identification document with a photograph (passport, identity card, driving license or some similar document) and puts on record the data required in point 22.

b) in the case of business relations entered into through correspondence

10 In the case of business relations entered into through correspondence or by internet, the bank verifies the identity of the contracting partner by obtaining a certified copy of an official identification document as set forth in point 9. above, as well as a confirmation of the domicile indicated, either through an exchange of correspondence or by any other appropriate method.

11 [1]The authentication of the copy of the official identification document may be provided by:

a) a branch, representative office or group company of the bank,

b) a correspondent bank or some other financial intermediary specifically appointed by the account opening bank,

c) a public notary or another public office that customarily issues such authentications.

[2]The identification based on an official identification document at delivery or receipt of mail is also deemed as sufficient proof of identity, provided that personal delivery to the recipient is thus warranted.

2. Legal entities and companies

a) with registered office in Switzerland

12 The bank ascertains whether the firm's name is published in the official Swiss Commerce Gazette ("Schweizerisches Handelsamtsblatt / Feuille officielle suisse du commerce") or listed on a public website for commercial register entries (e.g. www.zefix.ch). The bank may also use relevant private directories and databases ("Schweizerisches Ragionenbuch / Annuaire suisse du Registre du commerce"). Otherwise, the identity must be established by means of an extract from the Commercial Register ("Handelsregister / Registre du commerce").

13 The identity of legal entities and partnerships not listed in the Commercial Register (associations, foundations, collective condominium ownerships, independent public institutions and corporations) is verified on the basis of charters or any other equivalent document.

b) with registered office abroad

14 The identity of the contracting partner is verified by means of an extract from the Commercial Register or an equivalent document or extracts from public websites for Commercial Register entries or equivalent documents, substantiating the existence of the legal entity or company (such as a certificate of incorporation).

c) Common provisions

15 The extract from the Commercial Register or equivalent document must not be dated older than 12 months. A document dated older than 12 months may be used in conjunction with an audit report or a „certificate of good standing" dated not older than 12 months.

16 The verification of identity for associations, foundations and partnerships not entered in a Commercial Register, must include the verification of identity and documents for the persons opening the account, if they are authorised signatories.

17 [1]The identification requirements of a legal entity as set forth in points 12 to 14 may be waived if the identity of the contracting partner is publicly known. The identity is deemed publicly known if it is a public company or associated directly or indirectly with a public company. The bank must keep on file a record of the justification for waiving the procedures as set forth in points 12 to 14.

[2]The simplified procedure as stipulated in par. 1 is not applicable to domiciliary companies unless they are associated directly or indirectly with a public company.

3. Exceptions

18 It is not necessary to formally verify the identity of a contracting partner when opening

a) an account, deposit account or passbook in the name of a minor, provided that the assets deposited with the bank at the outset do not exceed an amount of CHF 25,000; however, the identity of the account opening adult person has to be verified; point 22 applies analogously; if the person opening an account, securities account or passbook is minor, the identity of such minor person has to be verified;

b) a rent guaranty account for a rented property located in Switzerland;

c) an account with a view to paying up capital stock in connection with the formation of a corporation or a limited liability company or an increase of its capital.

19 The procedure as set forth in points 9 to 14 becomes redundant if the contracting partner's identity had been verified previously in an equivalent manner within the bank's group. In this case, the respective members of the bank's group must hold copies of the original identification files. This provision is not applicable in cases where such transfer of data is banned by law.

20 In cases where the identity of the contracting partner cannot be verified in the manner required, for instance because an individual has no identity documents or because no official documents exist for a public corporation or institution, the bank may verify the identity in another effective manner by requiring other relevant documents or by obtaining relevant credentials from public authorities or, for legal entities, by obtaining the latest statement from an authorised auditing firm. Credentials and photocopies of alternative documents have to be kept on file, as well as an internal memorandum stating the reason for the exemption.

4. General regulations of identity verification and supervision

21 [1]The Bank may appoint an individual or a company by written agreement to verify the identity of a contracting partner, provided that

a. such mandatory has been instructed accordingly by the bank, and

b. the bank is able to monitor the proper execution of the verification of identity.

[2]The mandatory has to forward all identification documents to the bank and certify that any photocopies forwarded are identical with the corresponding originals.

[3]The appointment of a third party by the mandatory is prohibited.

22 Appropriate record is to be kept of the contracting partner's full name, date of birth, nationality and address of domicile (the firm's name and business address, if the contracting partner is a legal entity or a company), as well as of the means used to verify the identity. The date of birth and address of domicile may be omitted, if the contracting partner is domiciled in a country where such data is not customarily registered. A photocopy of the official document of identification and other identification documents must be kept on file.

23 The bank undertakes to ensure that its internal auditing department and the external auditing firm required by the Bank Act are in a position to verify that the required identification procedures have been complied with.

24 On principle, the complete credentials have to be in place in the appropriate form before an account can be used. If the bank is able to ensure through its control systems that any outstanding documents will be submitted within 30 days, an exception may be made to the effect of activating the account prior to the receipt of such documents. In this case, however, no withdrawals may be made by the client. If the documents remain outstanding after 30 days, the account has to be blocked. The bank has to terminate the business relationship if the documents are not complete within 90 days (cf. also art. 6, par. 4).

Art. 3 Establishing the identity of the beneficial owner

[1] All due diligence which can be reasonably expected under the circumstances must be exercised in establishing the identity of the beneficial owner. If there is any doubt as to whether the contracting partner is himself the beneficial owner, the bank shall require by means of Form A a written declaration setting forth the identity of the beneficial owner.

[2] This regulation applies to:

- **opening of accounts or passbooks;**
- **opening of securities accounts;**
- **entering into fiduciary transactions;**

- **entering into management agreements for assets deposited with third parties;**
- **the execution of transactions with securities, currencies as well as precious metals and other commodities exceeding the amount of CHF 25,000.**

[3]If the amount of a cash transaction as per art. 2 exceeds CHF 25,000, the bank must require the contracting partner to provide a declaration setting forth the identity of the beneficial owner. The bank shall keep such declaration on record in an appropriate manner. The use of Form A is optional.

25 [1]The bank may assume that the contracting partner is also the beneficial owner, but such an assumption is invalid if unusual observations are made.

[2]The following cases would give rise to doubt:

- when a power of attorney is conferred on someone who evidently does not have sufficiently close links to the contracting partner; this provision does not include a power of attorney for the management of asset given to a financial intermediary;
- when the financial standing of someone wishing to carry out one of the transactions described in art. 3 is known to the bank, and the assets submitted or about to be submitted are disproportionate to said person's financial standing;
- when, in the course of its relations with the customer, the bank is led to make other unusual observations.

26 A declaration on Form A must invariably be provided by individuals entering into a business relation with a bank through correspondence. Exempt are instances as provided in point 18.

27 If the contracting partner states that the beneficial owner is a third party, he or she shall fill in Form A disclosing the full name, date of birth, nationality, address and country of domicile (or the firm's name and business address, if the party is a legal entity or a company) of said third party. The bank reserves the right to apply art. 3, par. 3. The date of birth and address of domicile may be omitted, if the beneficial owner is domiciled in a country where such data is not customarily registered.

28 Form A may be signed by the contracting partner or his designated signatory authorised by means of a specific or general proxy. In the case of legal entities, form A or the proxy has to be signed by the registered signatories listed in the company's credentials.

29 If serious doubts persist about the accuracy of the contracting partner's written declaration and cannot be dispelled through further clarification, the bank shall refuse to enter into a business relationship or to execute the transaction.

30 Form A is attached to this agreement. This form can be obtained in English, French, German, Italian and Spanish from the office of the Swiss Bankers Association.

31 The banks have the right to print their own forms, reflecting their own particular requirements. These forms must contain the complete text of the sample form.

32 The holder of a joint account or a joint securities account is required to provide the bank with a full list of beneficial owners, pursuant to point 27, and to inform the bank of any changes without delay.

33 In the case of collective investments and investment companies with more than 20 investors as beneficial owners, the data as set forth in point 27 must be recorded only for the beneficial owners who hold severally or in joint agreement a minimum of 5% of the assets deposited with the bank. If the number of beneficial owners is up to 20, the bank must record the data as set forth in point 27 for all. No disclosure of beneficial owners is required in the case of collective investments listed on a stock exchange.

34 [1]In principle no declaration of beneficial ownership is required for banks domiciled in Switzerland or abroad. Their definition is governed by the relevant specific laws of their country of domicile. Beneficial ownership has to be declared for sub-accounts held on behalf of undisclosed clients by banks which are not subject to appropriate supervision and regulation in terms of anti money laundering provisions.

[2]No declaration of beneficial ownership is required for other financial intermediaries domiciled or resident in Switzerland. This regulation also applies to other financial intermediaries domiciled abroad, provided they are subject to adequate supervision and an adequate set of anti-money laundering regulations.

[3] Other domestic and foreign financial intermediaries are deemed: fund managements, life insurance companies, brokers and tax exempt pension funds pursuant to art. 2 par. 2 of the AMLA. The definition of foreign financial intermediaries is governed by the relevant specific laws of their country of domicile.

[4]The bank must require banks or other financial intermediaries to submit a declaration of the beneficial owners or take other measures if it has cause to assume misuse or if a general warning is issued by the Federal Banking Commission or the Swiss Bankers Association with respect to individual institutions or the institutions of a specific domicile.

35 [1]The establishment of the beneficial owner's identity may be delegated to a third party. The provisions under point 21 have to be applied analogously.

[2]Point 24 is applicable analogously in establishing the beneficial owner's identity.

36 The bank undertakes to ensure that the internal auditing department and the external auditing firm required by the Bank Act are in a position to verify that the identity of the beneficial owner has been established.

37 Special provisions apply to domiciliary companies or persons bound by professional confidentiality (art. 4 and 5, points 38 through 46).

Art. 4 Procedure for domiciliary companies

[1] Under the terms of this agreement, the entities considered domiciliary companies are institutions, corporations, foundations, trusts, etc., that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located.

[2] The banks must require that Swiss and foreign domiciliary companies provide the following documents:

a) an extract from the Commercial Register or an equivalent credential (cf. points 12 through 16) to verify their identity;

b) the declaration on Form A by the contracting partner indicating the beneficial owner(s) of the assets concerned.

[3]The use of Form A may be waived if the bank is familiar with the beneficial owner and is in possession of the data as per point 27. The bank shall, however, keep a record of the relevant data on file.

I. Domiciliary companies

38 Swiss and foreign enterprises are considered domiciliary companies, regardless of their objects, function, legal form or registered office, provided:

a) they do not have their own premises (domiciled c/o an attorney, a trust company, a bank, etc.), or

b) they do not have their own staff working exclusively for them, or their own staff engages solely in administrative tasks (bookkeeping and correspondence under instructions issued by individuals or companies controlling the domiciliary company).

39 Family foundations or other legal entities and companies whose purpose is to safeguard the interests of their members in joint self-help or who pursue primarily political, religious, scientific, artistic, welfare, social or such comparable purposes are deemed domiciliary companies if the bank concludes that the statutory purposes of such legal entities or companies are not exclusively pursued.

II. Beneficial ownership of domiciliary companies

40 The beneficial owner of a domiciliary company may be either an individual or a legal entity conducting a commercial or manufacturing business or any other form of commercial operation. A domiciliary company as such cannot be deemed a beneficial owner.

41 The identity of the beneficial owners must be established and kept on file in accordance with points 27 and 28. Point 29 refers.

42 The beneficial owners of a domiciliary company listed on a stock exchange need not be established.

43 In the case of organised associations of individuals, assets or patrimony without specific beneficial owners (eg.discretionary trusts), instead of identifying the beneficial owners on Form A the contracting partner is required to provide a written declaration confirming this fact. Such declaration must also contain information about the actual (not fiduciary) settlor and, if determinable, persons authorised to instruct the contracting partner or his or her agents, as well as persons who are likely to become beneficiaries (in categories, eg. "members of the settlor's family"). Any curators, protectors, etc. must also be included in said declaration.

44 In the case of revocable structures (e.g. revocable trusts), the actual settlor must be listed as beneficial owner.

III. Change in signing authority

45 If any changes are made in the signatures authorised by the domiciliary company in its relations with the bank, the bank must repeat the procedure set forth in art. 4, par. 2, letter b), unless the bank has evidence or is advised in writing by the management of the domiciliary company or its authorised signatories that the beneficial owners have remained unchanged. If the bank is unable to precisely establish the identity of the beneficial owners, art. 6, par. 3 is applicable.

Art. 5 Persons bound by professional confidentiality

The banks may waive the identification of beneficial owners of accounts or securities accounts held by attorneys or notaries for the account of their clients, provided that such attorney or notary is admitted to the Bar in Switzerland and declares in writing that said account or securities account is held exclusively for a purpose as stated below, and that such account or securities account is termed accordingly (type of mandate):

a) - winding-up and, so far as appropriate, related short-term deposit of advances on legal costs, security, fees under public law, etc. as well as of payments to or from parties, third party/parties or authorities (termed "winding-up account / securities account of client's funds");

b) - deposit and, so far as appropriate, related placement of assets from a pending partition of inheritance or execution of a will (termed e.g. "inheritance" or "partition of inheritance");

- deposit/placement of assets from a pending separation of property in the divorce or separation of a marriage (termed e.g. "separation of property / divorce of marriage");

- depositing of a security/placement of assets in matters of civil or public law (termed e.g. "escrow account/deposit", "blocked deposit account for purchase of stocks", "deposit of a security / corporate security", "deposit of a security / property income tax" etc.);

- deposit and, so far as appropriate, related placement of assets in matters of civil and public law before ordinary courts or courts of arbitration and in execution proceedings (termed e.g. "advances", "guarantee for court security", "bankrupt's estate", "arbitration proceedings", etc.).

46 [1]Form R is provided for the declaration under art. 5. This form can be obtained in German, French and Italian from the office of the Swiss Bankers Association in Basle.

[2]The banks have the right to print their own forms reflecting their own specific requirements. These forms must contain the complete text of the sample form (cf. annex).

Art. 6 Changes and errors with respect to the verification of the contracting partner's identity or the declaration of identity of the beneficial owner (art. 2 through 5 CDB)

[1]The bank has to repeat the procedure pursuant to art. 2, points 9 through 24, and art. 3 and 4, points 25 through 45

- **if, during the business relationship, the bank has cause to doubt**
  - **the accuracy of the information about the identity of the contracting partner,**
  - **that the contracting partner is identical with the beneficial owner, or**
  - **the accuracy of the declaration of beneficial ownership,**
- **if there are any signs of unreported changes.**

[2]If a bank discovers that a declaration pursuant to art. 5 of this agreement is inaccurate, it must require its contracting partner to declare the identity of the beneficial owner in Form A. If the contracting partner fails to provide a declaration setting forth the identity of the beneficial owner, the bank shall sever its business relations with said contracting partner.

[3]Banks are required to sever their relations with the contracting partner if the transactions carried out give rise to the assumption that the bank has been deceived when verifying the identity of the contracting partner, that the bank was wilfully given false information about the beneficial owner or if doubts persist with regard to the contracting partner's declaration upon implementation of the procedure as required under par. 1.

[4]Business relations must not be severed if circumstances necessitate a declaration pursuant to art. 9 of the AMLA.

47 Relations must be severed as quickly as it is possible to do so without violating the contract. If the bank is unable to reach the contracting partner owing to mailing instructions, it can postpone the severance of relations until the contracting partner's next visit or the bank's forwarding of correspondence.

B PROHIBITION AGAINST ACTIVE ASSISTANCE IN THE FLIGHT OF CAPITAL

Art. 7 Flight of capital

Banks may not provide any active assistance whatsoever in transferring capital outside countries whose laws prohibit said transfers or impose restrictions on the placing of funds abroad.

48 [1]Flight of capital is an unauthorised transfer of capital in the form of foreign exchange, banknotes or securities from a country that forbids or restricts such transfer abroad by its residents.

[2]The mere duty to report cross-border currency transfers is not deemed a restriction of capital movement.

49 Art. 7 does not apply to the transfer abroad of capital from Switzerland.

50 The following acts constitute active assistance:

a) receiving clients abroad by appointment outside the bank's own premises, for the purpose of accepting funds;

b) participation abroad in the setting up of offset transactions when the bank knows or, based on a combination of circumstances, should know that the offset is aimed at furthering the flight of capital;

c) active collaboration with individuals and companies that arrange for the flight of capital on behalf of third parties or who provide assistance to this effect:

- by remitting orders;
- by promising them commissions;
- by keeping their accounts, while the bank is aware that such individuals or companies are using their accounts for business purposes to assist in the flight of capital;

d) referring customers to the persons and companies described in letter c).

51 Visits to customers abroad are permitted provided the officer acting on behalf of the bank does not accept any funds that may not be legally transferred, gives no advice to assist in the illegal transfer of capital and does not participate in any offset transactions.

52 Otherwise, assets for foreign customers may be accepted in Switzerland.

C PROHIBITION AGAINST ACTIVE ASSISTANCE IN TAX EVASION AND SIMILAR ACTS

Art. 8 Tax evasion and similar acts

Banks shall not provide any assistance to their customers in acts aimed at deceiving Swiss and foreign authorities, particularly tax authorities, by means of incomplete or otherwise misleading attestations.

53 [1]It is forbidden to remit to the customer personally or, at his or her request, directly to Swiss or foreign authorities, any incomplete or otherwise misleading attestations.

[2] Authorities include, in particular, tax, customs, currency and bank supervisory authorities as well as prosecution authorities.

54 [1] Subject to this prohibition are special attestations requested by the customer for submission to authorities.

[2] The bank is not permitted to alter routine records, such as statements of account and securities, credit and debit advices, settlement notes for foreign exchange transactions, coupon and stock exchange transactions, for the purpose of deception.

55 [1] Attestations are incomplete if significant facts are omitted in order to deceive authorities; for example if the bank, at the given request of the customer, omits certain items from a given attestation or from a statement of account or securities.

[2] It is not necessary to mention in the statements of account or deposit that the same customer holds other accounts or deposits.

56 Attestations are misleading if the facts are presented in an untruthful manner to deceive the authorities, such as:

a) by showing false dates, false amounts or fictitious rates or by issuing credit and debit advices showing false information about the persons debited or credited;

b) by attesting to fictitious claims or debts (regardless of whether or not the attestation reflects the bank's records).

c) by allowing customers to use the bank's nostro accounts for the purpose of cutting tax duties.

D OTHER PROVISIONS

Art. 9 Numbered accounts

The provisions of this agreement apply without restriction to accounts, passbooks, securities accounts and safe deposits designated by a number or code.

57 Numbered or coded accounts, securities accounts, including fiduciary deposits, must be included in the attestations covering all the business relations with the customer.

Art. 10 Auditing

[1]By signing this agreement, the banks instruct and authorise their external bank auditors under the Bank Act to ascertain through random tests conducted during the regular auditing of the accounts that the provisions of this agreement have been complied with. The auditors required under the Bank Act shall inform the Supervisory Board set up pursuant to art. 12 and the Federal Banking Commission of any violations they may uncover or have reason to suspect.

[2]All officially recognised external bank auditors in Switzerland shall receive a copy of this agreement, together with a list of signatories, from the Swiss Bankers Association. This constitutes their auditing mandate.

Art. 11 Violation of the agreement; sanctions

[1]In the event this agreement is violated, the culpable bank is required to pay the Swiss Bankers Association a fine of up to 10 million Swiss francs. In fixing this fine, due account is taken of the seriousness of the violation, of the degree of culpability and of the bank's financial situation. Measures imposed by other authorities with respect to the same issue are to be taken into account. The amount of the fine is determined in accordance with the procedure provided under art. 12 and, if appropriate, art. 13. The Swiss Bankers Association may use the fine to cover any negative cost balance and allocates the remaining amount of the fine to a useful public purpose at its own discretion.

[2]In minor cases, the culpable bank may be sent a note of reprimand instead of being required to pay a fine.

[3]A fine or reprimand will only be decreed in the case of a violation of Art. 6 par. 1 and 2 as a result of gross negligence, or in the case of intentional violations of art. 7 and 8.

[4] The prosecution of a violation of this agreement is barred by statute upon a lapse of 5 years. In the case of a violation of the duty to verify the identity of the contracting partner and to establish the identity of the beneficial owner, the five-year statute period starts as of the rectification of the violation or the severance of the business relation.

Art. 12 Supervisory Board, Investigators

[1]The Swiss Bankers Association sets up a Supervisory Board composed of five independent experts, with a view to investigating and penalising violations under this agreement. The Supervisory Board appoints a secretary and regulates his or her responsibilities.

[2] The Swiss Bankers Association appoints one or more investigators. The investigators may recommend to the Supervisory Board that proceedings be opened and sanctions imposed or that the investigation be terminated. When requesting information from a bank, the investigators have to inform the bank of the capacity in which it is involved in the proceeding.

[3] The members of the Supervisory Board and the investigators are appointed for a term of five years, and may be reappointed.

[4] If the Supervisory Board finds that the agreement has been violated, it imposes an equitable sanction upon the culpable bank, in accordance with art. 11 above.

[5] The Supervisory Board establishes the rules of procedure and determines the allocation of costs.

[6] If the culpable bank abides by the decision of the Supervisory Board, the proceeding is closed. Otherwise, art. 13 applies.

[7] If a bank refuses to participate in the investigation conducted by the Supervisory Board or by the investigators, the Supervisory Board may impose a fine pursuant to art. 11.

[8] As authorised officers under the terms of art. 47 of the Bank Act, the members of the Supervisory Board, the secretary and the investigators are strictly bound to treat as confidential the facts about which they gain knowledge in the course of the proceeding. The banks may not invoke banking confidentiality vis-à-vis the Supervisory Board or the investigators.

[9] The Supervisory Board informs the Federal Banking Commission of its decisions. If it determines that abuses have been committed by persons subject to professional confidentiality, the Supervisory Board may also advise the appropriate disciplinary authority thereof.

58 The Supervisory Board periodically informs the banks and the general public of its findings, to the extent permitted by the rules of banking and business confidentiality.

59 The Supervisory Board may - in agreement with the Board of Directors of the Swiss Bankers Association - provide the banks with interpretations of this agreement. Banks shall submit according applications to the Swiss Bankers Association.

Art. 13 Arbitration procedure

[1]If the fine set by the Supervisory Board has not been paid by the date prescribed, an arbitration tribunal based in Basle will hand down, upon a complaint brought by the Swiss Bankers Association against the bank concerned, a final decision as to whether there has or has not been a violation of the terms of this agreement and, if applicable, will decide on the fine to be imposed. To this effect the banks submit themselves to the jurisdiction of the courts of Basle.

[2]The Swiss Bankers Association and the bank each appoint an arbitrator and the two arbitrators thus appointed jointly nominate an umpire.

[3]A petition for arbitration becomes pending as soon as the Swiss Bankers Association has designated the arbitrator it is entitled to appoint.

[4]If a party has not appointed its arbitrator within 30 days from receipt of the written notification from the other party announcing that arbitration proceedings have been commenced, or if the two arbitrators have not been able to agree on the appointment of an umpire within 30 days following acceptance of their appointment as arbitrators, the Court of Appeals ("Appellationsgericht") of the Canton of the City of Basle will proceed, at the request of one of the parties, to make the appointment.

[5]If an arbitrator is unable to discharge his office for any reason whatsoever, the party who appointed him must appoint a new arbitrator within 30 days, failing which the Court of Appeals of the City of Basle will proceed, at the request of the other party, to nominate the arbitrator.

[6]If the umpire is unable to discharge his office for any reason whatsoever, the two arbitrators must again name an umpire. If they fail to reach an agreement, the Court of Appeals of the Canton of the City of Basle will proceed with the appointment, at the request of either of the parties.

[7]If an arbitrator or an umpire is replaced in accordance with par. 5 and 6 above, the records of the proceedings in which the latter participated remain valid.

[8]Subject to the mandatory provisions of the Swiss Concordat on Arbitration and of the Code of Civil Procedure of the Canton of the City of Basle, the provisions of the latter apply only if the parties or, failing them, the court of arbitration adopt no other rule of procedure. The maxim of contingency is applicable no earlier than as of the second exchange of pleadings.

[9]The court of arbitration is subject to the same rule of confidentiality as that set forth in art. 12, par. 8.

Art. 14 Entry into force

[1] This agreement takes effect on 1st July 2003.

[2] The Swiss Bankers Association and each signatory bank may withdraw from this agreement, subject to three months notice, with withdrawal taking effect at the end of a contractual year but not earlier than 30th June 2008.

[3] The Swiss Bankers Association reserves the right to apprise the banks of supplementary regulations during the life of the agreement, upon agreement with or request by the Federal Banking Commission (cf. art. 16 AMLA).

[4] The Swiss Bankers Association reserves the right to unilaterally adjust or cancel the sanction rules (art. 11 through 13), if amended legal provisions or new legal practice should lead to inappropriate multiple sanctions for the same facts.

Art. 15 Transitional regulation

[1] The revised Form A is to be applied, if, upon entry into force of this agreement, a new business relationship is entered into or if the procedure of establishing the identity of a beneficial owner is to be repeated pursuant to art. 6 of this agreement.

[2] The new regulations governing the verification of identity of contracting partners and declaration of identity of the beneficial owners are applicable to new business relations entered into upon the date of enactment of this agreement or if the establishing of beneficial ownership must be revised pursuant to art. 6 upon the date of enactment of this agreement. The new agreement may be applied to existing business relations if it is deemed more beneficial.

J.22.4/5.12.02

EXHIBIT B

IN THE HIGH COURT OF THE COOK ISLANDS
HELD AT RAROTONGA
(CIVIL DIVISION) **PLAINT NO. 17/2001**

BETWEEN **A**

Plaintiff

AND **E** and **B**

First Defendants

AND **C** together with **D** in their capacity as Trustee(s) **THE TRUST**

Second Defendants

Counsel: **J R F Fardell QC and C Morris for Plaintiff**
A F Grant and P Collins for First Defendants

Hearing: **7 September 2002**

Judgment: **10 October 2002**

INTERLOCUTORY JUDGMENT CONCERNING FIRST DEFENDANTS' CLAIM OF PRIVILEGE IN RESPECT OF DISCOVERABLE DOCUMENTS

EDITED VERSION UNDER SECTION 23 INTERNATIONAL TRUSTS ACT 1984

CONTENTS

CONTENTS (continued)

Para Nos.

The Nature of the Proceedings

[1] The Plaintiff is a bank. The First Defendant E is a settlor and together with her husband First Defendant B and their children is a beneficiary of the Trust. B also transferred property to the Trust. The Trust is a registered international trust pursuant to the International Trusts Act 1984. C is a trustee company licensed pursuant to the Trustee Companies Act 1981-82 and carries on the business of the creation, establishment, maintenance and administration of international trusts.

[2] The Trust was purportedly established pursuant to a trust settlement dated 12 July 2000 made between the First Defendants and the Second Defendants as Trustees.

[3] The First Defendants are also the sole shareholders of P Inc, which was indebted to the Plaintiff under a US$17 million promissory note dated 31 May 1999. They unconditionally guaranteed full payment to the Plaintiff of all indebtedness owed under the note. P operated a chain of four stores in Maryland, USA.

[4] It was alleged that the First Defendants were in breach of their obligations as guarantors and arbitration proceedings were commenced by the Plaintiff against the First Defendants claiming in excess of US$17 million in July 2000. It is contended by the Plaintiff that while the arbitration proceedings were pending the First Defendants transferred assets to the Second Defendants in their capacities as Trustees of the Trust for no consideration.

[5] On 31 October the First Defendants consented to two arbitration awards against them and in favour of the Plaintiff for the amounts due under the guarantee. On 28 December 2000 the Circuit Court, State of Maryland, United States entered a judgment on the first arbitration award against the First Defendants.

[6] These proceedings are brought pursuant to section 13B(1) of the International Trusts Act which is set out in Appendix 1. The central allegation against the Defendants in these proceedings is as follows (Statement of Claim, paragraph 56):

> "That the transfer of the Residence, Furnishings and Liquid Assets to the Second Defendants as trustees of the Trust were made with the intention and effort to hinder, delay, deprive or defraud the Plaintiff and has left the First Defendants without property sufficient to satisfy the First Defendants indebtedness to the Plaintiff or in respect of the Guaranty evidenced by the judgment entered in the Circuit Court, State of Maryland entered on 28 December 2000 in favour of the Plaintiff in the amount of United States Dollars Sixteen Million Eight Hundred Forty One Thousand One Hundred and Twenty Dollars Twenty Nine Cents (USD$16,841,120.29) together with pre-judgment interest in the amount of United States Dollars Six Hundred Thirty Five

Thousand Forty Dollars and Sixty Cents (USD$635,040.60) plus post-judgment interest and costs pursuant to the First Defendants consenting to an arbitration award dated 31 October 2000 against them in favour of the Plaintiff for amounts due under the Guaranty."

[7] It is important to note that under section 13B(1) the Plaintiff must establish its case beyond reasonable doubt.

[8] Subsequently leave was sought and obtained to file an Amended Statement of Claim incorporating a new cause of action. This is based on certain terms of the Trust Deed which require the Trustees to pay any person determined to be a creditor of the settlors of the Trust in certain circumstances. It is not necessary to set out the details of this cause of action for the purposes of this decision.

<u>Application by the Plaintiff in Respect of the First Defendants' Claim for Privilege</u>

[9] By application dated 29 August 2002 the Plaintiff applied for orders against the First Defendants as follows:

> "1. An Order that the Court inspect the documentation for which privilege has been claimed as highlighted on the attached list of documents marked "A" to this application; and/or
>
> 2. An Order allowing the plaintiffs to inspect such documentation as in this Court's opinion privilege has been invalidly claimed by the First Defendants.
>
> 3. Costs on a solicitor/client basis."

[10] As to the grounds for the application, these were listed as follows:

> "(a) the list of documents provided by the first defendants claims legal professional privilege and/or litigation privilege for categories of documents where advice was sought or given to allow the first defendants to commit a fraud; and
>
> (b) prima facie evidence of fraud with sufficient foundation in fact exists to deny the claim for legal professional privilege and/or litigation privilege; and
>
> (c) an inspection by the Court of the documents in Schedule "A" is warranted in all the circumstances to determine whether a prima facie case of fraud is established justifying the overturning the claimed privilege..
>
> (d) the documents highlighted include documents that are inadequately identified, as follows:
>
> (i) by date; and/or
>
> (ii) described as 'non responsive'; and/or
>
> (iii) described as discoverable."

[11] With respect to what is referred to under (d)(ii) and (iii), at the commencement of the hearing on 7 September 2002 Mr Grant for the First Defendants explained that the annotation "non-responsive" meant that the document was no longer considered discoverable and that the annotation "discoverable" meant that the documents had already been provided to the Plaintiff. On the basis of these explanations Mr Fardell for the Plaintiff agreed to withdraw those grounds with leave reserved to reapply. They were therefore struck from the application.

[12] The application then proceeded to provide the particulars of the evidence of fraud alleged to be sufficient to justify inspection by the Court as follows:

> "1. The dishonest acts and intentions of the first defendants as assisted and promoted by lawyers and/or advisers as can be proved and/or inferred from the following uncontested acts carried out by the first defendants or by agents/advisers/lawyers on their behalf to the sole benefit of the first defendants and to the calculated loss and harm to the plaintiff.
>
> (i) the establishment and creation of the Trust; and
>
> (ii) the transfers of assets to the Trust; and
>
> (iii) at a time when an arbitration case was pending against the first defendants; and
>
> (iv) a silence from the first defendants regarding what lawful purpose was served by establishing the Trust; and
>
> (v) the transfers were made without any consideration to a Trust located 7,000 miles from E and B's domicile; and
>
> (vi) the creation of the Trust within three weeks of the plaintiff's demand for arbitration; and
>
> (vii) the effect of the transfers was to leave E and B unable to meet their obligations to the plaintiff.
>
> 2. Such dishonest acts and intentions of the first defendants have been the subject of depositions and judgments in the United States.
>
> 2.1 A ruling by Judge W where the Court said:
>
> '(i) *the Court also concludes that there is a substantial likelihood that the Bank will be able to prove E and B intended to hinder, delay or defraud their creditors when they made the various transfers described above;*
>
> (ii) *the timing of the creation of the Trust and the transfers of assets to it, while an arbitration case was pending against E and B, under circumstances where it was simply a matter of time before a substantial award would be made in favour of the Bank, coupled with the unmistakable silence from E and B regarding what lawful purpose was served by establishing the Trust, clearly points to a circumstance where the only*

possible purpose to creating the Trust was to prevent the Bank from collecting its judgement'

2.2 Judge Y in April 2002 said at page 12:

> *'I think it's important that a number of these factual findings be read into the record so that there is no doubt that <u>there has been a proper showing of the commission of fraud</u> in this case by these debtors'.*

2.3 Privilege has been invoked and not waived by the first defendants as can be seen by the depositions.

2.4 The deposition of M is evidence that the agents (namely the attorneys for E and B) were aware the actions described above amounted to fraud."

[13] Additional grounds advanced in support of the application were said to be contained in the affidavits of F and G. In the course of the hearing reference was also made to the affidavit of H filed in support of the Plaintiff's earlier application in these proceedings for a Mareva Injunction.

[14] The First Defendants filed a Notice of Opposition dated 5 September 2002 opposing the making of the orders sought on the following bases:

"(a) **Concerning Orders 1 and 2**:

(i) The documents listed in the plaintiff's schedule "A" are properly the subject of the privileges which have been claimed for them.

(ii) There is no, or no sufficient evidence of any facts or factors which would justify dispensing with the privilege and allow the plaintiff to inspect the documents.

(iii) The litigation in which Judge W's decision was delivered was based upon the Statute of Elizabeth (1571), a statute which is expressly excluded from the operation and effect of the International Trusts Act by virtue of s.13B(13) of that Act.

(iv) Further, to the extent that the plaintiff relies upon the decision of Judge W, the proceedings before him were materially different in form to those which are the subject of the plaintiff's claim in this proceeding. In particular, information relating to the assets which the first defendants reasonably believed themselves to possess at the time of the establishment of the trust, and at the time of dispositions to it, was clearly regarded by the Judge as having little relevance.

(v) To the extent that the plaintiff relies on the decision of Judge Y, the legal framework of the proceedings in which his decision was given was materially different to the framework in this proceeding. He was not provided with evidence by the first defendants concerning the extent of their assets and their solvency as at the date of creation of the trust or the dispositions to it, since these were not material to the application which he heard on 30 April 2002.

(vi) The orders would, if made, conflict with the statutory guarantee of privacy concerning the establishment, constitution, business undertaking or affairs of an international trust, in terms of s.23(1) of the International Trusts Act, and would generally be in conflict with the intended effect and operation of that statute.

(vii) The plaintiff relies upon inadmissible evidence in support of its application, namely the depositions taken in Maryland, USA, which have been annexed to the plaintiff's affidavits filed in support of the application.

(viii) The first defendants reasonably believed at the time of the creation of the trust and at the time of the dispositions to it that they had sufficient assets to pay any liability which they had to the plaintiff.

(ix) If (which is denied) grounds exist for allowing the inspection by the plaintiff of the first defendants' privileged documents, the range of documents sought to be inspected by the plaintiff is far greater than would otherwise be permissible by law."

[15] The First Defendants also filed substantial affidavits from O, J, K, L and B.

Legal Framework

[16] There was no serious dispute about the applicable rules of discovery. Cook Islands and New Zealand law are in all material respects the same. The Code of Civil Procedure of the High Court of the Cook Islands 1981 has the same general scheme for discovery as the New Zealand High Court Rules. In relation to privilege, Rule 143 of the Cook Islands Code provides that "[w]here, on an application for an order for inspection, privilege is claimed for any document, the Court may inspect the document for the purpose of deciding whether the claim of privilege is valid". Rule 143 is identical to Rule 311 of the New Zealand High Court Rules. The central issue for determination is the scope and application of the so-called fraud exception to the rules about withholding documents on discovery on the grounds that they are privileged from production.

[17] Counsel for the Plaintiff relied upon the leading New Zealand Court of Appeal authorities on the operation of the fraud exception, namely: *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650; *Seamar Holdings Ltd v Kupe Group Ltd* [1995] 2 NZLR 274; and *Gemini Personnel Ltd v Morgan & Banks Ltd* [2001] 1 NZLR 672.

[18] Counsel for the First Defendants did not seek to challenge the principles set out in these cases or their applicability in the context of Cook Islands' trust law. However, the topic deserves a more detailed analysis for several reasons.

[19] Firstly, this appears to be the first case to consider the exception in the context of a claim by a creditor under section 13B(1) of the International Trusts Act. The question of whether privilege attaches to communications between the defendants and their legal advisers

regarding the establishment and funding of the trust could be an important or even a crucial one in some instances.

[20] Secondly, the parties (most of whom are resident in foreign jurisdictions) should know and understand the precise legal basis for my ruling, especially since claims to legal professional privilege may be approached differently in U.S. jurisdictions.

[21] Thirdly, the law in this area is not free from debate, particularly in relation to the scope of the fraud exception and the standard of proof required before disclosure is ordered.

Rationale of the Fraud Exception

[22] As to the nature of the privilege and the rationale behind the fraud exception, the privilege exists to encourage a client to confide fully and candidly in his or her legal adviser: *Waugh v British Railways Board* [1980] AC 521 at 531 per Lord Wilberforce. As the Australian Judges Mason and Wilson JJ put it in *Waterford v Commonwealth* (1987) 61 ALJR 350 at 353, "[t]he wisdom of the centuries is that the existence of the privilege encourages resort to those skilled in the law and that this makes for a better legal system".

[23] The Courts in all jurisdictions have been loath to derogate from the cloak of confidentiality that covers client/legal adviser communications despite the conflict with the interest of the community as a whole in seeing justice fairly done. McMullin J said in *R v Uljee* [1982] 1 NZLR 561 at 576 that "[w]hether the [privilege] operates as a bar to the emergence of the truth and to the overall public detriment is not now a legal consideration".

[24] More recently, in *Auckland District Law Society v B* (2001) 15 PRNZ 687 Elias CJ said at 689 – 690:

> "Legal professional privilege protects from disclosure confidential communications between a client and his legal adviser for the purpose of legal advice. Such protection is essential if advice is to be candidly informed and given. Where the advice is sought in connection with litigation, the privilege is an important part of the fundamental right of unimpeded access to the Courts. Even where litigation is not immediately in prospect, the privilege recognises the public benefit in legal professional assistance if members of the community are to avoid disputes and order their affairs lawfully. As such, it supports the principle of legality upon which our society is organised. Legal professional privilege is subject to exceptions. It does not protect advice for purposes of fraud or illegality. And it may be limited by legislation. In the absence of express statutory language, such an important protection could be displaced only by statutory implication which, as a matter of interpretation of the statute, is clearly necessary."

[25] However, at least since the decision in *R v Cox and Railton* (1884) 14 QBD 153, the law has recognised an exception where communications are made with intent on the client's

part to facilitate crime or fraud because if the privilege protected such communications from disclosure it would pervert the underlying rationale for the privilege – to promote the interests and administration of justice. In *R v Cox and Railton*, Stephen J explained (page 167):

> "The reason on which the rule is said to rest cannot include the case of communications, criminal in themselves, or intended to further any criminal purpose, for the protection of such communications cannot possibly be otherwise than injurious to the interests of justice, and to those of the administration of justice. Nor do such communications fall within the terms of the rule. A communication in furtherance of a criminal purpose does not 'come into the ordinary scope of professional employment'".

[26] Thus the privilege is not lifted from communications in furtherance of either crime or fraud. Privilege never attaches to them at all as the nature of the communications made destroys the sanctity of the relationship between lawyer and client.

[27] It is the intent of the client in seeking the advice that is overriding. Whether the legal adviser is cognisant of the client's criminal or fraudulent purpose is not relevant. If a lawyer participates (innocently or otherwise) in the criminal purpose he or she ceases to act as a lawyer. The relationship which gives rise to the privilege does not exist in such circumstances. The exception does not apply to advice sought in aid of a legitimate defence by the client against a charge of past crimes or past misconduct, even if he is guilty. Those consultations are privileged. As Stephen J said in *R v Cox and Railton* at 175:

> "... in each particular case the Court must determine upon the facts actually given in evidence or proposed to be given in evidence, whether it seems probable that the accused person may have consulted his legal adviser, **not after the commission of the crime for the legitimate purpose of being defended, but before the commission of the crime for the purpose of being guided or helped in committing it.**" (Emphasis added).

[28] Admissions made to a legal adviser after the commission of an offence in order to instruct the legal adviser in preparation of a defence must be privileged otherwise the legal adviser could be subpoenaed to give evidence against his own client as to admissions made to him or her by the client. This would fly in the face of the right of every person to a proper and adequate defence.

The Fraud Exception in New Zealand Case Law

[29] In the absence of Cook Islands authority it is convenient to begin with a brief review of the New Zealand Court of Appeal decisions. *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 involved an appeal from a judgment of the High Court declining an application that a ruling on the production of allegedly privileged documents be

dealt with by a judge other than the trial judge. The Court of Appeal at page 653 cited with approval the leading English case *O'Rourke v Darbishire* [1920] AC 581 and set out part of the leading speech by Viscount Finlay (page 604):

> "This is clear law, and, if such guilty purpose was in the client's mind when he sought the solicitor's advice, professional privilege is out of the question. But it is not enough to allege fraud. If the communications to the solicitor was for the purpose of obtaining professional advice, there must be, in order to get rid of privilege, not merely an allegation that they were made for the purpose of getting advice for the Commission of a fraud, but there must be something to give colour to the charge. The statement must be made in clear and definite terms, and there must further be some prima facie evidence that it has some foundation in fact. It is with reference to cases of this kind that it can be correctly said that the Court has discretion as to ordering inspection of documents. It is obvious that it would be absurd to say that the privilege could be got rid of merely by making a charge of fraud. The Court will exercise its discretion, not merely as to the terms of which the allegation is made, but also as to the surrounding circumstances, for the purpose of seeing whether the charge was made honestly and with sufficient probability of its truth to make it right to disallow the privilege of professional communication. In the present case it seems to be clear that the appellant has not shown such a prima facie case as would make it right to treat the claim if professional privilege is unfounded".

[30] The Court of Appeal then commented (pages 653 - 654):

> "The important point is that, however the test should be expressed precisely (if indeed complete precision is possible), no more than a prima facie threshold has to be crossed. The judge is of course not called upon to express any concluded opinion as to whether or not there has been a fraud. He or she is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence."

Scope of the Fraud Exception

[31] In general, Commonwealth Courts are very protective of the sanctity of communications between clients and their legal advisers. They are not easily persuaded that the veil of privilege should be lifted. It is not surprising that the exception was first articulated in a criminal case – *R v Cox and Railton* (1884) 14 QBD 153. The traditional approach was to confine the exception to communications in furtherance of criminal purposes or fraudulent purposes, fraud being either criminal or at least the tort of deceit. However, since *R v Cox and Railton*, the approach of the English Courts and, more recently and particularly, the Australian Courts, has been a more liberal one.

[32] The English cases are conveniently summarised in the judgment of Vinelott J in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 171 to 177. Vinelott J observed that the scope of the exclusion from legal professional privilege in civil litigation (what is meant in this context by "fraud") was very widely defined by Kekewich J in *Williams v*

Quebrada Railway, Land and Cooper Co [1895] 2 Ch 751. In the *Williams* case the client, who was seeking to assert the privilege, argued that the alleged fraud was "of a very mild character" and fell short of the cases in which it had been held that a charge of fraud prevents privilege attaching to the communication. Kekewich J rejected that argument, holding that (page 755):

> "... where there is anything of an underhand nature or approaching to fraud, especially in commercial matters, where there should be the veriest good faith, the whole transaction should be ripped up and disclosed in all its nakedness to the light of the Court. ... Then it is alleged that the company was insolvent, and that they found it useless for them to continue to carry on business and they had to stop, but that in order to prevent for a time this inevitable result they gave a charge in favour of their agents, and, as the plaintiff alleges, they did it in such a way as to defeat the holders of first debentures. That is what I understand the plaintiff's case to be, and it is said that is not a charge of fraud. It is difficult to say it is not commercial dishonesty. It is, in my opinion, commercial dishonesty of the very worst type; and that is fraud."

[33] Vinelott J also referred to two decisions of Goff J (as he then was) – *Crescent Farm (Sidcup) Sports Ltd v Sterling Offices Ltd* [1971] 3 All ER 1192; and *Gamlen Chemical Co (UK) Ltd v Rochem Ltd (No. 2)* (1979) 124 SJ 276. In the *Crescent Farm* case the plaintiff sought to extend the fraud exception to include the purpose of obtaining advice to further an alleged conspiracy to induce a breach of contract. Goff J held (at page 1200):

> "... I think the wide submission of the plaintiffs would endanger the whole basis of legal professional privilege. It is clear that parties must be at liberty to take advice as to the ambit of their contractual obligations and liabilities in tort and what liability they will incur whether in contract or tort by a proposed course of action without thereby in every case losing professional privilege. **I agree that fraud in this connection is not limited to the tort of deceit and includes all forms of fraud and dishonesty such as fraudulent breach of trust, fraudulent conspiracy, trickery and sham contrivances**, but I cannot feel that the tort of inducing a breach of contract or the narrow form of conspiracy pleaded in this case come within that ambit." (Emphasis added.)

[34] In the *Rochem* case, Goff LJ approved the finding of Goulding J in the Court below, where Goulding J said:

> "For servants during their employment and in breach of their contractual duty of fidelity to their master to engage in a scheme, secretly using the master's time and money, to take the master's customers and employees and make profit from them in a competing business built up to receive themselves on leaving the master's service, I would have though that commercial men and lawyers alike would say that that is fraud."

[35] Goff LJ referred to the *Williams* case and then added:

> "Where you draw the line in the infinite gradation of good and evil between *Williams's* case (Kekewich J) and the *Crescent Farm Sports* case ... I do not attempt to say, but I have no doubt the present case is on the same side as *Williams's* case and that discovery ought to be given ... I wish only to add two further observations. First the

> court must in every case, of course, be satisfied that what is prima facie proved really is dishonest, and not merely disreputable or a failure to maintain good ethical standards and must bear in mind that legal professional privilege is a very necessary thing and is not lightly to be overthrown, but on the other hand the interests of victims of fraud must not be overlooked. Each case depends on its own facts."

[36] Also in the *Rochem* case, Templeman LJ put the exercise of the discretion as follows:

> "In the light of the existing evidence, and without knowing if, at the trial, that evidence will be disproved, we must, adopting the words of Stephen J, determine whether it seems probable that the defendants may have consulted their legal advisers before the commission of fraud and for the purpose of being guided and helped wittingly or unwittingly in committing the fraud. A fortiori, if the defendants embarked on a fraudulent activity, communications between the defendants and the solicitors made in the course of that activity cannot be entitled to privilege and must be disclosed so that, in the words of Kekewich J, quoted by Goff LJ, "the whole transaction shall be ripped up and disclosed in all its nakedness to the light of the Court"."

[37] Thus it is not necessary to suspect any conspiracy between the client and his legal advisers in furtherance of fraud for the exception to operate. The legal advisers may be completely unaware of the client's fraudulent purpose.

[38] The High Court of Australia has decided that the exception includes communications made to further a deliberate abuse of statutory power: see *Attorney-General (NT) v Kearney* (1985) 61 ALR 55. It has also accepted the contentious proposition that "where there is a higher public interest than that which supports the privilege, the privilege is displaced": *Re Bell, ex parte Lees* (1980) 146 CLR 141 at 155. In *Re Bell* the Court determined that legal professional privilege does not apply to protect a solicitor from disclosing confidential information relating to the whereabouts of a child who is the subject of a custody order. The Court decided that the public interest in the welfare of the child outweighed the public interest in the confidentiality of solicitor/client communications.

[39] It may be that the principle espoused in *Re Bell* is confined to cases where the welfare of a child is at stake, although the High Court of Australia did not expressly limit its decision in this way. The authors of *McNicoll on Evidence* (1992) argue that to extend the exception to any case where a higher public interest prevails over the public interest which the privilege is designed to secure would tend to destroy the certainty required for the effective operation of legal professional privilege. To subject the circumstances of every case to a balancing exercise between public interests would leave every solicitor and client on shifting sands as to whether privilege would attach to their discussions and communications. There is much force in these observations.

[40] The Australian Law Reform Commission in its 1987 Report on Evidence (Report No. 38) expressed concern that *Kearney's* case had the potential to create the untenable situation where a lawyer and client could have no certainty about whether their communications were protected or not. The New South Wales Evidence Bill 1991 and the Australian Law Reform Commission Bill (clauses 111 and 107 respectively) restrict the exception to cases of crime or fraud or abuse of statutory power. The New Zealand Law Commission, in its 1999 Evidence Code (Report No. 55, clause 71) set the limits of the exception at "**a strong prima facie case** that the communication was made or received or the information was compiled or prepared for a **dishonest purpose** or to enable or aid anyone to commit or plan to commit what the person claiming the privilege knew, or reasonably should have known, to be an offence". (Emphasis added.)

[41] The theme of the cases and the various suggested codifications is one of dishonest purpose. The scope of the fraud exception goes beyond deceit or fraud simpliciter and catches any commercial practice or business dealing that would readily be described as dishonest to the point of fraud by a reasonable businessman. Beyond this, further generalities are probably not helpful.

[42] It remains to consider under this subheading whether the limits of the exception should be more restricted in the context of the statutory asset protection regime in the Cook Islands. There is an argument that the limits of the exception should be restricted to communications in furtherance of crime or fraud simpliciter given the asset protection purposes of Cook Islands statutes such as the International Trusts Act and the fact that there is a requirement of proof beyond reasonable doubt under that Act if a creditor such as the Plaintiff is to recover under section 13B(1). This argument was alluded to in submissions by Mr Grant for the First Defendants. Subject to what is said later on the related topic of the burden of proof, however, I do not see any reason for a more restrictive approach. There is no express statutory provision that excludes or limits the operation of the exception. Nor does the Cook Islands' asset protection legislation seek to exclude creditors entirely in their efforts to recover from settlors and beneficiaries of international trusts. It simply limits the opportunity of creditors to retrieve trust assets. Within those limitations, however, there is no reason to interpret established evidential rules in a way more adverse to the creditors of international trusts than to other parties. I am fortified in this view by the decision of the Cook Islands Court of Appeal in *515 South Orange Grove Owners Association v Orange Grove Partners & Ors* (Court of Appeal, Cook Islands, CA 1/95, 6 November 1995, Sir

Duncan McMullin, Hillyer and McHugh JJ). In that case, the Court of Appeal rejected an argument that the purpose of the Cook Islands trust legislation was purely and unashamedly the soliciting of funds and giving of protection against creditors exercising their rights (page 24):

> "We return to the purposes for which the legislation was passed. We find some difficulty in pursuing a purposive approach to the International Trusts Act. There is no long title in the Act from which its overall intention may be derived. On one view, the purpose of the Act may be said to be to provide a haven which protects funds deposited with trust companies to the exclusion of the rights of creditors. On another view, the purpose of the Act may be said to protect funds against actions by creditors but only after giving those creditors a chance of recovery within certain time limits.
>
> In the end we think the Court should strive to give a common sense approach to a piece of legislation which is at once very sophisticated but also ineptly drafted in parts. We think that the better view is that Parliament, in attempting to balance the interest of settlors, trustees and creditors, has prescribed certain specific limitation periods; that the right to sue on either a cause of action or a judgment is abridged but not eliminated, and that a common sense interpretation should allow for intention to be given to those two concepts. It should not be lightly assumed that Parliament intended to defeat the claims of creditors by allowing international trusts to be used to perpetrate a fraud against a creditor."

[43] Later, at page 27, the Court of Appeal said:

> "… we would be loathe to interpret the International Trusts Act as a statute which was intended to give succour to cheats and fraudsters by totally excluding the legitimate claims of overseas creditors.
>
> To modify the aphorism of Scrutton LJ in *Czarnikow v Roth, Schmitt & Co* [1922] 2 KB 478 at 488, we cannot think that Parliament ever intended that by passing of the International Trusts Act the Cook Islands should become an Alsatia in the South Pacific from which the commercial comity of nations was completely ousted."

Communications in Furtherance of Fraud and those in Furtherance of Defence to Allegations of Fraud

[44] A client seeking advice on how to defend past conduct (even if guilty) must be able to appraise his legal advisers of the situation and formulate a strategy without any fear that those communications will be disclosed without the client's consent. If it were otherwise, every defendant who faced a prima facie case of fraud would be obliged to disclose his or her litigation strategy and brief to opposing parties. Counsel for the First Defendants referred me to a comment by Vinelott J in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 178 to this effect:

> "The plaintiffs are not entitled to disclosure of any documents which fall under a different head of privilege: legal advice obtained and documents coming into existence for the dominant purpose of being used in pending or contemplated proceedings".

[45] This distinction may be of relevance in this case given that the First Defendants may have been contemporaneously transferring assets to the trust and seeking advice as to potential recovery proceedings by the Bank in the Cook Islands.

Standard of Proof of Fraud Required for Disclosure

[46] The test has been variously described. It is clear that a mere allegation of fraud is insufficient. There must be "something to give colour to the charge" (Viscount Finlay in *O'Rourke* at page 604). How much colour is required must in the end be a question of discretion on the facts of each particular case. Viscount Finlay said (page 604):

> "[T]here must further be **some** prima facie evidence that [the allegation of fraud] has **some** foundation in fact." (Emphasis added.)

On a literal reading, this appears to be a liberal test. In contrast, Lord Denning MR said in *Buttes Gas and Oil Co v Hammer (No. 3)* [1980] 3 All ER 475 at 486:

> "No privilege can be invoked so as to cover up fraud or iniquity. But this principle must not be carried too far. No person faced with an allegation of fraud could safely ask for legal advice. To do away with the privilege at the discovery stage there must be <u>strong evidence of fraud</u> such that the court can say: '<u>This is such an obvious fraud that he should not be allowed to shelter behind the cloak of privilege</u>'." (Emphasis added.)

In the same case, Donaldson LJ said (page 490):

> "[I] find it unnecessary to express any view on how strong a prima facie case of fraud is necessary to defeat a claim for disclosure based on legal professional privilege, but <u>something exceptional is called for</u>." (Emphasis added.)

[47] However, some judges have taken a more relaxed view of the test. Vinelott J suggested in *Derby & Co Ltd v Weldon (No. 7)* [1990] 2 All ER 161 at 177 that these differing formulae may be:

> "... a continuous spectrum and it is impossible to, as it were, calibrate or express in any simple formula the strength of the case that the plaintiff must show in each of these categories."

Additionally, in *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 at 653 the New Zealand Court of Appeal doubted whether complete precision is possible and concluded that (page 654):

> "No more than a prima facie threshold has to be crossed. ...[the judge] is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence."

[48] A prima facie case involves such evidence as is sufficient to establish the group or chain of facts constituting the party's claim and which if not rebutted or contradicted will remain sufficient to sustain judgment for the Claimant. To establish a case of fraud under section 13B, the fraud must be proved beyond reasonable doubt. For this reason the Cook Islands' asset protection legislation requires in my view a possible "raising of the bar" in terms of the standard of proof of fraud required before disclosure will be ordered, at least compared to the less stringent test espoused by Viscount Finlay in *O'Rourke v Darbishire* [1920] AC 581. The standard should be that proposed by the New Zealand Law Commission and referred to in paragraph 40 above, namely a strong prima facie case of fraud or dishonest purpose, or as Lord Wrenbury put it in *O'Rourke* (as cited below in paragraph 52) "a strong probability that there was fraud".

Standard of Proof of Fraud Required Before a Judge will Exercise Power of Inspection

[49] Counsel for the Plaintiff relied upon the following passages from the New Zealand Court of Appeal's judgment in *Seamar Holdings Ltd v Kupe Group Ltd* [1995] 2 NZLR 274 at 278 – 279:

> "Accordingly there seems to be no authority directly on the point of whether a Judge must be satisfied (and if so to what degree) that there is or may be fraud before he might exercise the right to inspect documents to determine whether they should be open to inspection by the other parties.
>
> If it were correct that the Judge must find sufficient evidence the fraud entirely outside of the documents before overruling the claim for privilege it would be pointless inspecting the documents at all. But we were referred to no authority requiring a threshold finding of prima facie fraud entirely outside the document. *R v Governor of Pentonville Prison, ex parte Osman* is to the contrary and is treated as authoritative on the point: see Phipson on Evidence (148 ed 1990) para 20-26. In these days when greater openness in litigation is required and where Rule 311 gives an unfettered right to inspect, good reason would be needed to justify any such rigid threshold. No such reason was advanced. In our view it would be artificial in ruling on a disputed claim to privilege to seek draw a distinction between evidence of fraud and documents made in furtherance of it so as to permit judicial inspection of the documents for one purpose but not the other …".
>
> "A judge will not automatically inspect but as a matter of judgment will no doubt satisfy himself or herself that the circumstances warrant exercising the power of inspection and that it is likely to be of assistance. We see no reason to impose anything more."

[50] Since Rule 311 of the High Court Rules is identical to Rule 143 of the Cook Islands Code of Civil Procedure, judicial inspection is a matter entirely within the judge's discretion should it be necessary to determine the issue of disclosure one way or the other.

The Facts – Introduction

[51] There are a number of preliminary matters which must be addressed before taking stock of the material that is legitimately before the Court and reaching a decision on whether the Plaintiff has established a strong prima facie case of fraud in the sense of dishonest purpose. In particular, the following issues arise:

(a) what weight, if any, can be placed on the decisions of Judge W and Judge Y (together "the Maryland Decisions");

(b) should any weight by placed on the deposition of M;

(c) should account be taken of the evidence filed for the Plaintiff in support of its Mareva Injunction application and does the grant of the Mareva Injunction itself support the Plaintiff's allegation of a prima facie case of fraud; and

(d) whether the nature of the Defendants' claim to privilege on some documents is in itself corroborative of the Defendants' alleged knowledge that their actions were fraudulent.

[52] In considering these matters it is to be remembered that this stage in the action is only an interlocutory one and the materials must be weighed, such as they are, without the benefit of a formal trial process. The approach of Lord Wrenbury in *O'Rourke v Darbishire* [1920] AC 581 at 633:

> "If I may venture to express this in my own words I should say that to obtain discovery on the ground of fraud the plaintiff must show to the satisfaction of the Court good ground for saying that prima facie a state of things exists which, if not displaced at the trial, will support a charge of fraud. This may be done in various ways – admissions on the pleadings of facts which go to show fraud – affidavits in some interlocutory proceedings which go to show fraud – possibly even without admission or affidavit allegations of facts which, if not disputed or met by other facts, would lead a reasonable person to see, at any rate, a strong probability that there was fraud, may be taken by the Court to be sufficient. Every case must be decided on its merits."

Relevance of the Maryland Decisions

[53] The Plaintiff put forward the rulings of Judge W (of the Circuit Court) and Judge Y (of the United States Bankruptcy Court) that the establishment and endowment of the Trust by the First Defendants constituted a fraudulent act. The specific statements within those judgments on which the Plaintiff relies are set out in the Plaintiff's current application and are set out in paragraph 12 of this Judgment.

[54] Whether rulings of this kind can be recognised and taken into account at common law is conveniently discussed in Hill, *International Commercial Disputes* (2nd Ed, 1998) at 12.3 and following. It is not proposed to take Judge W's and Judge Y's rulings into account for two reasons, neither of which involve a reflection on the quality of the judgments. The first is that while this Court is asked to give a decision involving the same parties (at least insofar as the Bank and E and B are concerned), the present application involves different issues and different standards of proof and falls to be determined on the basis of a different governing law from that addressed by Judge W and Judge Y. The common law requires identity of causes of action or issues: see Hill at 12.3.21.

[55] The affidavit of J, the lead litigation counsel for E and B in the United States who has appeared on their behalf before both Judge W and Judge Y, sets out some of the parameters and circumstances within which the Judges evaluated the rights of the Plaintiff and E and B. It appears from J's affidavit and the judgments themselves that their Honours' task differed from that of this Court in the following respects.

[56] Firstly, it does not appear that the extent of the evidence before either Judge W or Judge Y was the same as the evidence before this Court. For example, Judge W referred to "unmistakable silence from E and B regarding what lawful purpose was served by establishing the Trust…". In contrast, this Court has the benefit of an explanation in paragraph 11 of B's affidavit dated 4 September 2002.

[57] Secondly, both Judges were dealing with statutes whose genesis was the Statute of Elizabeth 1571. The International Trusts Act, specifically section 13B(13), excludes the application of the Statute of Elizabeth to trusts registered after 1991.

[58] Thirdly, whether the settling, establishment or any disposition to a trust is a fraudulent act under the International Trusts Act depends in part on whether the Settlor intended to defraud creditors. Intention to defraud was not a relevant factor in terms of the determinations of Judges W and Y. What may be termed fraudulent in the United States does not necessarily amount to fraud under Cook Islands law.

[59] Fourthly, it appears that Judge W's decision was of an interlocutory nature and therefore any finding of fraud was not a final decision but merely one that there was a sufficient case to justify an interim injunction.

[60] Lastly, section 13D of the International Trusts Act 1984 provides inter alia that:

> "... no proceedings for <u>or in relation to</u> the ... recognition of a judgment obtained in a jurisdiction other than the Cook Islands against any interested party shall be in any way entertained, recognised or enforced by any Court of the Cook Islands to the extent that the judgment –
>
> (a) is based upon the application of any law inconsistent with the provisions of this Act ...". (Emphasis added.)

[61] The wording of this provision is sufficiently wide to cover the use of the U.S. decision which the plaintiff proposes in this interlocutory matter.

[62] For these reasons, the decisions of Judge W and Judge Y do not assist me in determining pursuant to Cook Islands law whether there is a prima facie case of fraud sufficient to displace the privilege to which the Defendants would otherwise be entitled in this case.

The Deposition of M

[63] The deposition of M is not entitled to any weight in the present application. M is a former employee of the Colorado law firm engaged by the First Defendants to establish the Trust. In a deposition given in the U.S. proceedings M claimed that certain partners at his former firm had expressed concern about the legitimacy or propriety of the establishment and funding of the Trust. The Plaintiff points to M's allegations as supporting the likelihood that the Trust was set up for fraudulent purposes. The First Defendants have filed affidavits from the partners concerned, a K and L, who both deny any concern about the propriety of the Trust and deny making any statements to the contrary to M.

[64] Quite apart from the inherent nature of a "deposition" in American civil procedure – a procedure alien to New Zealand or Cook Islands law – it was open to the Plaintiff to file an affidavit from M if it wished his evidence to be taken into account. In the absence of such an affidavit, all the Court has before it are the sworn denials from K and L. Those are accepted for the purpose of this decision.

[65] Further, the Defendants have filed affidavits from B (paragraph 13) and O (E and B's commercial attorney in Maryland – paragraph 15) asserting that neither they nor any other attorney in O's firm spoke with M. Anything M has to say about E and B's intention in setting up the Trust is plainly hearsay.

[66] Finally, K and L also set out various details surrounding M's departure from the firm. It is not necessary to go into the details, but without any sworn version of events from M, the matters raised by K and L are sufficient to give me concern about the reliability of M's account as disclosed in his deposition.

Affidavits in Support of and the Granting of Mareva Injunction

[67] The Plaintiff filed an ex parte application for a Mareva Injunction on 28 June 2001. Affidavits of F dated 28 June 2001 and N were filed in support of the application. The significant affidavit for present purposes is that of F.

[68] I am prepared to look at these affidavits and take them into account for the purposes of this decision. They were sworn and filed well over a year ago. Where the First Defendants have not contested any matter to which F deposes, I have taken it to be reliable evidence of the particular fact for the purpose of deciding this interlocutory application.

[69] However, the fact that a Mareva Injunction was granted has little or no bearing on the merits of the present application. This is for the obvious reason that the application was, as usual, made and granted on an ex parte basis. This Court now has before it considerable additional material, being in large part the affidavits filed on behalf of the First Defendants. This material was not before Greig CJ. In addition, factors such as those that go to the balance of convenience and to a lesser extent some factors that go to the overall justice of the case when dealing with an application for a Mareva Injunction are not matters that I need to weigh in order to reach a conclusion about the present application.

Whether the Defendants' Claim of Litigation Privilege Corroborates the Allegation of Fraudulent Knowledge

[70] For the Plaintiff, Mr Fardell submitted:

> "...the nature of the privilege claimed is in itself corroborative of the defendants' knowledge of their action. In the main the documents claim a privilege marked "C". Class "C" falls within the litigation privilege claim as defined on page 23 of the list of documents. Accordingly E and B are asserting that they were contemplating this litigation at the time of setting up the Trust (refer doc 289-291 being dated 22 May 2000). In other words the defendants contemplated being sued for fraudulent conveyances sevens month [sic] before the plaintiffs were ever aware of a cause of action."

[71] The document to which the Plaintiff refers is listed as "O Notes re: birthdates and family Trusts 22 May 2000". The First Defendants and the second-named Second

Defendant, D, claim three separate heads of privilege in respect of documents contained in their list of documents. The categories of privilege are described as follows:

> "1. **Legal Professional Privilege**
>
> a) The documents marked **"A"** consist of:
>
> (i) communications or records of communications between the 1st defendants and the 2nd named 2nd defendant and their legal advisers to provide instructions to, and receive instructions from, their legal advisers; and
>
> (ii) communications or records of communications between legal advisers relating to the provision of legal advice.
>
> 2. **Litigation Privilege**
>
> The documents classified under "litigation privilege" were made after this proceeding was in contemplation and for the purpose of enabling the legal advisers to advise the 1st defendants and 2nd named 2nd defendant and conduct their defence.
>
> a) The documents marked **"B"** consist of:
>
> (i) communications or records of communications between the 1st defendants, 2nd named 2nd defendant and their various legal advisers; or
>
> (ii) communications or records of communications between agents for the 1st defendants or 2nd named 2nd defendant and the 1st defendants' and 2nd named 2nd defendant's legal advisers.
>
> b) The documents marked **"C"** consist of the 1st defendants' and 2nd named 2nd defendant's legal advisers' briefs, file notes and internal memoranda."

[72] The First Defendants' categorisation of heads of privilege in general and the categorisation of the specific document referred to by the Plaintiff are somewhat odd. In relation to the specific document mentioned, neither the date nor the description of the document appears to support any claim for privilege on the basis that it was "made after this proceeding was in contemplation and for the purpose of enabling the legal advisers to advise the First Defendants and second named 2nd Defendant and conduct their defence". Further, from my perusal of the First Defendants' list of privileged documents, it appears that privilege has been claimed for the same reasons (for the purpose of defence to proceedings in contemplation) for a number of documents the descriptions of which appear to be nothing to do with the proceedings but rather to do with the establishment and funding of the Trust. For example, there are numerous entries where the category "C" privilege is claimed for documents described as "O Notes re: Trust" or "O Notes re: Transfers to Trust" or, in the extreme, "O Notes re: Art Appraisal". There are numerous other examples. It is hard to see

how an art appraisal can be a document made in contemplation of the present proceedings and for the purpose of conducting the Defendants' defence.

[73] The confusion probably lies in the First Defendants' categorisation of privilege. The point is that all of the different types of documents referred to in the First Defendants' categorisation in fact come under the heading "Legal Professional Privilege". In New Zealand and Cook Islands law, "litigation privilege" is a useful (at times) subheading of legal professional privilege that is properly used to refer to privilege claimed in relation to communications between a client and/or the client's legal advisers and **third parties**. Such communications will be privileged if they are made for the dominant purpose of pending or contemplated litigation.

[74] In contrast, communications between a client and his or her legal advisers are always privileged (subject to the exception discussed in this judgment), regardless of whether any litigation is pending or in contemplation so long as the client intended the communication to be a confidential one and for the purpose of obtaining legal advice. If in fact litigation happens to be anticipated at the time the communication between a client and legal adviser is made, that simply goes to the question of whether the communication was intended to be confidential. So long as it was so intended, the communication is privileged (again subject to the exception discussed herein). Lord Denning put it succinctly in *Buttes Gas and Oil Co v Hammer (No. 3)* [1980] 3 All ER 475 at 484:

> "The first [category of privilege] is legal professional privilege properly so called. It extends to all communications between the client and his legal adviser for the purpose of obtaining advice. It exists whether litigation is anticipated or not."

See also *Cross on Evidence* (5th NZ Ed, 1996) at 10.20.

[75] Accordingly there is no need for the First Defendants to divide client/legal adviser communications into those relating to instructions to and advice from their legal advisers (categorisation "A") and those where the client/legal adviser communications occurred and were recorded once litigation was contemplated and for the purpose of defending that litigation (categorisations "B" and "C"). However, what is important in this context is not the niceties of delineation between different heads of privilege. What is relevant is the scope of the fraud exception to all documents that come under the heading of legal professional privilege. It is to be noted, however, that in relation to the particular document identified by the Plaintiff, it is not appropriate to take much from it at this point. The explanation for the

privilege classification for the document may lie in confusion relating to categories of privilege or differences in the law of privilege between the United States and the Cook Islands. As will be seen, nothing turns on the significance of this particular point in any event.

[76] What is important is the line to be drawn between documents subject to legal professional privilege that are in furtherance of a dishonest purpose as opposed to communications for the purpose of a defence after the alleged fraudulent or dishonest purpose has been attempted or achieved. This distinction does have an effect on the outcome of this application.

[77] Finally, I do not overlook that Vinelott J referred to "legal advice obtained and documents coming into existence for the dominant purpose of being used in pending or contemplated proceedings" as falling under a "different head of privilege" in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 178. With respect, in the context of *Derby & Co Ltd v Weldon* the Judge was referring to the limits of the exception to the privilege rather than attempting to delineate between particular heads of privilege within legal professional privilege. In my view, the better formulation of the limits of the exception is that espoused by Stephen J in *R v Cox and Railton* (1884) 14 QBD 153 set out in paragraph 27 above.

A Chronology Derived from the Affidavit Evidence

[78] I am left with the matters deposed to in the affidavits of F Jr dated 28 June 2001 (filed in support of the Plaintiff's application for a Mareva Injunction) and the affidavits filed for the First Defendants in opposition to the present application from B and O. The other affidavits filed for the First Defendants dealt with matters to which I have already referred.

[79] From these affidavits one may establish a chronology of what I consider (at this interim stage and for the purposes of this decision) to be the important events, none of which can be seriously disputed.

April 1995 – Sept 1999	E and B's company, P Inc., opened four stores" [E affidavit, paragraph 2].
24 March 1988	The Plaintiff made a line of credit available to P in total and not to exceed US$17 million. [F affidavit, paragraph 5].

31 May 1999	The line of credit matured but was renewed pursuant to the terms of a promissory note dated 31 May 1999 executed by P to the order of the Plaintiff [affidavit, paragraph 5].
31 May 1999	E and B guaranteed payment to the Plaintiff of all indebtedness under the promissory note absolutely and unconditionally. [F affidavit, paragraph 6].
31 May 2000	The promissory note matured. As a result, all indebtedness to the Bank under the promissory note and the guarantee signed by E and B became immediately due and payable by P and E and B. The amount owing to the Bank under the promissory note at this point was approximately US$16.2 million [F affidavit, paragraph 7; O affidavit, paragraph 10].
5 June 2000	The Plaintiff demanded payment from P and E and B of the money owed under the promissory note before 5pm on 12 June 2000. The demand was not met [F affidavit, paragraph 8].
Circa April to June 2000	In the (Northern Hemisphere) late spring/early summer of 2000 E and B decided to sell the stores and instructed O to assist [O affidavit, paragraph 4].
Circa June 2000	Efforts to sell the stores commenced. The initial asking price was US$15 million [E affidavit, paragraph 6].
June 2000 – circa Dec 2000	Efforts to sell the stores continued. Initial interest was shown by retail chain stores Q and R. Negotiations began with R [E affidavit, paragraphs 7 and 8; O affidavit, paragraphs 5 to 7].
23 June 2000	E and B were served with a notice of claim and demand for arbitration notifying them that the Plaintiff claimed that E and B were indebted to the Bank and demanded arbitration of E and B's liability to the Bank under the guarantee. [F affidavit, paragraph 9].

12 July 2000	A notice was issued by S (the arbitration forum agreed by the parties under the guarantee) officially notifying the parties that arbitration proceedings had been initiated [F affidavit, paragraph 12].
12 July 2000	E and B formed the Trust [F affidavit, paragraph 13; E affidavit, paragraph 10].
18 July 2000	The Bank served its Complaint in the arbitration proceedings [F affidavit, paragraph 19].
26 July 2000	E and B served their Answer to the Bank's Complaint [F affidavit, paragraph 20].
1 August – circa Oct 2000	E and B transferred assets to the Trust for minimal consideration. The transferred assets include E and B's residence in Maryland, a second property in Georgia, the furnishings and artwork contained in the Maryland residence and cash, shares and interests in partnerships worth over US$16 million. Mr F's affidavit states at paragraph 43 that the last transfer occurred on 28 November 2000. However the transfers detailed at paragraphs 23 to 34 of his affidavit indicate that the final transfer took place in October 2000. However, little if anything turns on the particular date of the final transfer. All the particular assets mentioned above appear, on the evidence before me, to have been transferred prior to the end of October 2000 [F affidavit, paragraphs 21 to 36].
7 August 2000	A PricewaterhouseCoopers valuation report on P was issued (although the copy annexed to O's affidavit is stamped "Draft"). The report valued P at US$12.7 million [O affidavit, paragraph 6 and exhibit 2]. (Whether this was fair market value at the time will no doubt be a contested issue at trial.)

31 October 2000	E and B consented to two arbitration awards against them in favour of the Bank totalling over US$17 million [F affidavit, paragraph 38].
28 December 2000	The Circuit Court entered judgment against E and B for an amount over US$17 million including interest and costs [F affidavit, paragraph 39].
End of 2000	R indicated that it was not in a position to proceed with the purchase of the stores [O affidavit, paragraph 7].
Late December 2000	Approximately US$14 million in cash and US$729,000 in stocks and other investments were transferred by the Trust to a Swiss bank, U [F affidavit, paragraph 47]. There was no explanation in the First Defendants' affidavits as to the purpose of this transfer.
Circa 2001	P filed for bankruptcy protection [O affidavit, paragraph 9].
January 2001	The Plaintiff Bank learned of the existence of the Trust [F affidavit, paragraph 46].
Circa March-May 2001	In (Northern Hemisphere) Spring 2001, R filed for bankruptcy protection [O affidavit, paragraph 7].

[80] I also note the following matters. Firstly, E and B and their children have continued to live in the residence in Maryland and enjoy the furnishings and artwork without (on the evidence before me) payment of any rent for these items to the Trust.

[81] Secondly, it appears from F's affidavit that most of E and B's assets that remain in the United States (apart from their shares in P) cannot be reached by creditors. These assets comprise interests in partnerships controlled by E's father, D, who is named as one of the Second Defendants in this proceeding (as trustee of the Trust). In F's assessment, these partnerships are unlikely to distribute any proceeds to E until she has resolved her dispute with the Plaintiff. Whether or not this is so, there is no evidence before me to suggest that E has made any efforts to release any value in any of her assets remaining in the United States to facilitate payment of the First Defendants' debt to the Bank.

[82] Thirdly, the Bank has recovered approximately US$3.4 million from the sale of P's assets, the stores' stock and fixtures.

[83] Fourthly, O points out in his affidavit (paragraph 8) that in connection with the Plaintiff's loan to P, the Bank had a lien against all of P's assets. Accordingly, after the loan became due on 1 June 2000, the stores were operating at the Bank's sufferance because it could have closed down the operations at any time by executing the lien.

[84] Finally, B has provided the following explanation for the creation of the Trust and the transfers of assets to it at paragraph 11 of his affidavit:

> "The Trust was established and funded upon the advice of O and another principal in his firm, V, who concentrates in the field of estates and trusts. As part of our estate planning, we decided to preserve the value of assets by placing them in the Trust for the benefit of our children. By having a trustee with responsibility for administering and safeguarding the assets, they would be protected from potentially ill-advised business ventures or expenditures of other kinds which we and, eventually, our children might otherwise undertake. The assets also would be protected from future creditors of ours and/or our children. As described in paragraph 10 of this Affidavit, we felt confident that we could satisfy our then creditors from assets not placed in the Trust, such as P, and the Partnerships."

Decision

[85] The Plaintiff contends in essence that the timing of the establishment of the Trust and the transfers to it, occurring immediately after demand for payment by the Bank and commencement of arbitration proceedings to recover the debt, gives rise to a strong inference that actions were undertaken to defraud E and B's creditors. The First Defendants, on the other hand, say that the Trust was established and funded for the legitimate purpose of future asset protection for themselves and their children. They say that they believed that the assets they had left after funding the Trust would be sufficient to satisfy their outstanding creditors. In my view the Plaintiff has satisfied the strong prima facie test by reference to the establishment of the Trust in the shadow of an impending arbitration and judgment (eventually by consent) for a very substantial sum. Although E and B profess legitimate reasons for the establishment of the Trust, a careful reading of B's explanation reveals no persuasive reason for its timing or the rapid transfer of assets to it thereafter. If, in fact, E and B were establishing a trust for legitimate reasons, it is perhaps odd that they had not done so before. They are clearly wealthy and sophisticated business people who had been taking business risks involving substantial borrowings since the establishment of the first store in

1995. Full evidence at trial may lead to the prima facie case falling away and the Plaintiff failing to satisfy the beyond reasonable doubt test contained in section 13B but as matters stand a strong prima facie case has been established, especially since the requirement under section 13B(1) is to demonstrate that the "principal intent", not the sole intent, was to defraud.

[86] To the extent that E and B claim to have left sufficient assets in the United States to satisfy the Bank, this of course was dependent largely on the successful sale of the stores at a good price. This was by no mean guaranteed at the time the Trust was set up on 12 July 2000. It was early days in the sale process. Obviously adverse events might take place – and indeed they did. As at 12 July 2000 there was no agreement for sale and purchase or even a heads of agreement. The asking price of US$15 million had been set by E and B and O. The PricewaterhouseCoopers valuation did not arrive until 7 August 2000, by which time transfers to the Trust had already begun.

[87] All this is not to say that the Plaintiff will succeed at a full hearing on the matter. This decision is made on the basis of the strong prima facie threshold, which is to be contrasted with the much higher threshold that the Plaintiff will have to reach at trial (beyond reasonable doubt) due to the terms of section 13B(1) of the International Trusts Act. There will be further evidence and cross-examination if the matter proceeds to a full hearing. Accordingly this decision in no way prejudges the ultimate issue or outcome. As was said in *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 at 654:

> "The Judge is of course not called upon to express any concluded opinion as to whether or not there has been fraud. He or she is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence. Judges are well accustomed to giving rulings as to the existence or otherwise of a prima facie case, without in any way compromising their ultimate findings. They are also well accustomed to excluding form their minds in deciding an issue or directing a jury upon it evidence which they have seen or hears (as on a voir dire hearing) but have ruled inadmissible (compare *Hardy v Booth* [1992] 1 NZLR 356)."

Documents which May Fall Outside the Exception

[88] I do have a concern about the line to be drawn between documents created that may record or may be communications in furtherance of a fraudulent purpose and those created for the legitimate purpose of advising on and preparing for the defence to the allegations in the statement of claim.

[89] In my view there is a distinction to be drawn between documents which are or record communications for the purpose of establishing and funding the Trust and the intentions behind doing so on the one hand and those documents that are or record communications for the legitimate purpose of defending proceedings against E and B or the Trust and trustees. By "defending the proceedings" I do not include evidence of arrangements made as part of the litigation strategy to evade enforcement of any judgment (be it the arbitration judgment or any possible judgment against the Defendants in this proceeding). Otherwise, fraudulent arrangements could be made to frustrate the enforcement of any judgment while proceedings were on foot and those discussions would be protected by the inviolable privilege that protects client/solicitor communications (and communications with third parties in some circumstances) for the purpose of defending civil or criminal litigation.

[90] In this case, I stress that any communications relating to the establishment and funding of the Trust, the intention behind doing so and the subsequent movement of funds in and out of the Trust are, prima facie, communications in furtherance of a fraudulent purpose. Such communications, where recorded in documents sought by the Plaintiff in the highlighted segments of the Defendants' list of documents (attached to the Plaintiff's application), must be disclosed.

[91] If, however, any of those documents contain in whole or in part records of communications that have the legitimate purpose of defending subsequent allegations of fraud levelled after the commission of the alleged fraudulent acts – i.e. after the establishment of the Trust, the transfers to it and the movement of funds in and out of the Trust – then those communications retain privilege and are not to be disclosed.

[92] It is difficult to be exact about which of the documents that the Plaintiff seeks fall in which category on the limited information contained in the Defendants' list of documents. This is particularly so because many of the documents listed do not include a date. From the limited information that I have to go on in the list of documents, it appears to me that all the documents sought by the Plaintiff should be disclosed. However, I will reserve leave for any of the Defendants to apply to exclude any specific document or class of documents which they consider to fall outside the scope of the type of documents that I have ordered to be disclosed. On any such application I will most likely inspect any such document or class of documents and make a specific ruling in relation to them in line with the principles that I have outlined in this judgment.

Result

[93] The First Defendants are to disclose to the Plaintiff all of the documents highlighted on the list of documents annexed to the Plaintiff's present application within two weeks of the date of this interlocutory judgment. Disclosure is subject only to leave for the Defendants to apply to this Court within that same two weeks for a determination in relation to any specific document that would otherwise be required to be disclosed as to whether the document may be in furtherance of a fraudulent purpose or for the legitimate purpose of advising on and preparing for the defence to the allegations in this proceeding.

Costs

[94] Counsel are to submit memoranda on costs within 21 days.

Addendum: Publication and Reporting of Proceedings and this Judgment – Section 23, International Trusts Act 1984

[95] This judgment is now delivered to the parties for their own private information. The parties should not publish this decision lest they commit a breach of section 23(2). The Court has an obligation under section 23(3) to publish or report this judgment for the purposes of affording a record of these proceedings. However, editing must first be undertaken and no decision may be reported or published until the Court has ascertained the views of the parties as to the adequacy of the editing. Thereafter, the Court must certify to the Registrar that the decision as edited may be released for publication or reporting. An edited version of this judgment will be supplied shortly. If any parties have any views as to the nature of the editing please provide such comments in writing within 14 days of receipt of the edited version. If a party has no comments or suggestions, would that party please send a letter indicating its assent to the proposed editing.

David Williams J

EXHIBIT C

Summary of State Rule Against Perpetuities Laws

State	Rule Against Perpetuities?	Statute Setting forth RAP, Repealing RAP, or Providing Exceptions to RAP
Alabama	Yes	Ala. St. §35-4-4
Alaska	Yes	AK ST §34.27-051 *et seq.*
Arizona	Yes*	ARS §§33-261, 14-2901 *et seq*. *But no trust need ever terminate if the trustee has the power to sell assets and the trust was revocable at creation.
Arkansas	Yes	Common Law
California	Yes	Cal. Prob. Code §§21200—21231
Colorado	Yes	CRS §15-11-1101 *et seq*.
Connecticut	Yes	Conn. Gen. Stat. §45a-491 *et seq*.
Delaware	Yes*	25 Del. C. §503 *No RAP on personal property in trust, 110 years on real property in trust.
D.C.	Yes	DC ST §19-901 *et seq.*
Florida	Yes	FL ST §689.225 *et seq.*
Georgia	Yes	OCGA §44-6-200 *et seq*.
Hawaii	Yes	HRS §525 *et seq*.
Idaho	**No**	ID Code §§55-111
Illinois	Yes*	IL ST Ch. 765, §305/4 *No RAP for trusts created after 1/1/98 if trust expressly states that the RAP doesn't apply, and the trustee has the power to sell assets.
Indiana	Yes	Ind. Code §32-17-8-1 *et seq*.
Iowa	Yes	Iowa Code §558.68
Kansas	Yes	KSA §59-3401 *et seq*.
Kentucky	Yes	KRS §381.215
Louisiana	Yes*	LA RS §9:1803 *No "real" RAP; interests must vest immediately.

GSBT

State	Rule Against Perpetuities?	Statute Setting forth RAP, Repealing RAP, or Providing Exceptions to RAP
Maine	Yes*	33 ME RSA §§101—106 *No RAP for trusts created after 9/18/99 if trust expressly states that the RAP doesn't apply, and the trustee has the power to sell or mortgage property or to lease property for any period beyond the time required for an interest created under the instrument to vest in order to be valid under the RAP.
Maryland	Yes*	MD Est. & Trust §§11-102(e), 11-103 *No RAP if trust expressly states that the RAP doesn't apply, and the trustee has the power to sell or mortgage property or to lease property for any period beyond the time required for an interest created under the instrument to vest in order to be valid under the RAP.
Massachusetts	Yes	MGLA c. 184A §1 *et seq.*
Michigan	Yes	MCLA §§554.51, 554.53, 554.71 to 554.78
Minnesota	Yes	Minn. Stat. §501A.01 *et seq*.
Mississippi	Yes	Common Law
Missouri	Yes	Common Law
Montana	Yes	Mont. Code Ann. §72-2-1001 *et seq*.
Nebraska	Yes	Neb. Rev. Stat. §76-2001 *et seq*.
Nevada	Yes	NRS §111.103 *et seq*.
New Hampshire	Yes	Common Law
New Jersey	**No**	NJSA §§46:2F-9—46:2F-11
New Mexico	Yes	NMSA §45-2-901 *et seq*.
New York	Yes*	NY Est. Pow. & Trust §9-1.1 *Perpetual Trust Legislation is pending in New York as of the date of publication. 2003 NY S.B. 2292
North Carolina	Yes	NC Gen. Stat. §41-15 *et seq*.
North Dakota	Yes	NDCC §47-02-27.1 *et seq*.
Ohio	Yes*	OH ST §2131.08 *Repealed for certain trusts, as provided for in OH ST §§1746.14, 1747.09, and 2131.09

State	Rule Against Perpetuities?	Statute Setting forth RAP, Repealing RAP, or Providing Exceptions to RAP
Oklahoma	Yes	OK Const. Art. 2, Sec. 32: 60 OS Sec. 175.17
Oregon	Yes	ORS §105.950 *et seq*.
Pennsylvania	Yes	20 Pa.C.S. §§6104—6107
Rhode Island	**No**	RI GL §34-11-38
South Carolina	Yes	SC ST §27-6-10 *et seq*.
South Dakota	**No**	SDCL §43-5-8
Tennessee	Yes	TCA §66-1-202 *et seq*.
Texas	Yes	TX Prop. Code §112.036
Utah	Yes*	UT ST §75-2-1203 *et seq*. Recently extended to 1,000 years after the creation of a nonvested interest.
Vermont	Yes	27 VSA §501
Virginia	Yes	Va Code §55-13 *et seq*.
Washington	Yes	RCW §11.98.130 *et seq*.
West Virginia	Yes	W.Va. ST §36-1A-1
Wisconsin	**No***	Wis. Stat. §700.16(5) *No RAP if the trustee has the power to sell trust assets, or if a person in being has an unlimited power to terminate the trust.
Wyoming	Yes*	WY ST §34-1-139 *RAP recently extended to 1,000 years for trusts created after 7/1/03 if trust states that the trust will terminate no later than 1,000 years after the trust's creation, the trust is governed by Wyoming law, and the trustee maintains a place of business in, administers the trust in, or is a resident of, Wyoming. Traditional "21 years after a life in being" RAP still applies to real property in trust.

JURISDICTIONAL CHECKLIST

Overview of Selected Jurisdictions

Jurisdiction	Bahamas	Bermuda	Cayman Islands	Cook Islands	Cyprus	Gibraltar	Guernsey	Isle of Man	Jersey	Liechtenstein	Nevis
Contingent Fee Contracts	Not Allowed	Not allowed	Generally not allowed	Not allowed	Not allowed	Allowed	Not allowed	Generally not allowed	Not allowed	Not allowed	Not allowed
Language	English	English	English	English	Greek	English; most also speak Spanish	English	English	Official language of the courts is French; English is permitted	German; English also used	English
Deposit to Bring Action	None	None	None	Discretionary	None	None	None	None	None	Yes	Yes
Punitive Damages	Allowed	Not allowed	Not allowed	Not allowed	Generally not allowed	Allowed	Allowed	Not allowed	Allowed, with limitations	Not allowed	Allowed, with limitations
Registration of Trusts Required	No	No	Not generally	Yes	No	Yes	No	No	No	Yes	Yes
Confidentiality/ Secrecy Laws	Yes	Common law protection well-established	Yes	Yes	Yes	Yes	Yes (non-statutory)	Yes	Yes, with limitations	Yes	Yes
Rule Against Perpetuities	Yes	Yes, but modified with respect to purpose trusts	Does not apply to STAR trusts	No	100 years	100 Years	Yes	Yes	Yes	No	100 years
Self-Settled Asset Protection Trusts	Allowed by statute	Allowed by statute	Allowed by statute	Allowed by statute	Allowed	Allowed by statute	Allowed by statute	Allowed by common law	Allowed by statute	Allowed by statute	Allowed by statute

G S B T

Jurisdiction	Bahamas	Bermuda	Cayman Islands	Cook Islands	Cyprus	Gibraltar	Guernsey	Isle of Man	Jersey	Liechtenstein	Nevis
Statute of Limitations for Fraudulent Transfer Claims	Two years	Yes[1]	Six years	Must accrue w/in 2 years before transfer but barred if not brought w/in 1 year after	Two years	If pass solvency test, the assets are immediately protected	None	None[2]	None[3]	Five years[4]	Must accrue w/in 2 years before transfer but barred if not brought w/in 1 year after
Hague Convention on Taking Evidence Abroad	Yes	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes
Burden and Standard of Proof for Fraudulent Transfer Claims	On creditor	On creditor, to prove on balance of probability that dominant purpose was to put property beyond reach of creditors	On creditor	On creditor, to prove beyond a reasonable doubt	On creditor, to prove by prepond-erance of evidence	On creditor, to prove by prepond-erance of evidence	On creditor, to prove by prepond-erance of evidence	On creditor, to prove by preponderance of evidence, except where fraud is alleged, then creditor must prove beyond a reasonable doubt	On creditor, to prove by prepond-erance of evidence	On creditor, to prove intent to defraud with near certainty	On creditor, to prove beyond a reasonable doubt
Remedy When Transfer Proved Fraudulent	Trust rendered void	Trust rendered void	Trust not necessarily rendered void	Access to trust assets; trust not rendered void	Trust rendered void	Trust rendered void	Access to trust assets fraudulently transferred; trust will be void if they are the only assets	Trust rendered void	Trust rendered void	Access to trust assets, trust not rendered void	Access to trust assets, trust not rendered void
Statutory Conflicts of Law Provisions	Yes, local law applies	Yes, local law applies	Yes	Yes, local law applies	Yes, there are certain statutory provisions	Yes, local law applies	None	No	Yes, there are certain statutory provisions	There are certain statutory provisions, but choice of law provision in instrument will be readily enforced	Yes, with limitations

Jurisdiction	Bahamas	Bermuda	Cayman Islands	Cook Islands	Cyprus	Gibraltar	Guernsey	Isle of Man	Jersey	Liechtenstein	Nevis
Foreign Judgments	Recognized	Generally not recognized; certain judgments may be registered and enforced in limited circumstances	Generally recognized	Not recognized	U.K. and certain others recognized	U.K. and E.U. recognized	U.K. and certain others recognized	Limited recognition	U.K. and certain courts in Guernsey and Isle of Man recognized	Swiss and Austrian judgments recognized in limited circumstances	Not recognized
Local Taxes on Foreign Trusts	No	No	No	No	No	No	No	No	No	CHF 1,000 per annum	No

1. Bermuda - Only causes of action accruing before the transfer or within two years after the transfer can be pursued, but the creditor has six years from the date of the transfer to bring the action before the action is barred.

2. Isle of Man - In the prebankruptcy context, a settlement will be set aside if: (i) the transaction was intended to defraud creditors; (ii) the transaction was for either no consideration or at a discount; and (iii) the transaction's purpose was to withhold property from creditors. In the bankruptcy context, a bankruptcy within ten years of a trust's settlement will automatically result in voiding the trust unless the beneficiaries can establish that, at the time of settlement, the settlor was able to pay all of his debts with money held outside the trust. A bankruptcy within two years of settlement will automatically void the trust regardless of the settlor's solvency.

3. Jersey - No limitations period because an action to set aside a transfer as a fraud on creditors is an action to declare the transfer void. However, if the claim is founded in tort, there is a three-year statute, and if it is founded in contract, there is a ten-year statute.

4. Liechtenstein - The general limitations period is five years from the time the trust was settled with regard to causes of action accruing before settlement. If a creditor (before the claim becomes enforceable or before it is clear that execution against the debtor's other assets will not completely satisfy the claim) notifies the debtor of its intention to contest the transfer by means of a court-served notice, then the limitations period runs from the time of the notice. Because creditors must prove intention to defraud them, it is almost impossible for future creditors to defeat a transfer. However, actual fraud does not have to be proved if a creditor obtains an execution order within one year of the transfer. A notable point in this context is that foreign bankruptcy proceedings are recognized by Liechtenstein courts only if there is reciprocity. Because there are no such treaties in existence, Liechtenstein courts have not recognized bankruptcy proceeding of other countries, with the consequence that new proceedings must be instituted in Liechtenstein.

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