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THE ASSET PROTECTION TRUST: HOLY GRAIL, OR WHOLLY USELESS?

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Introduction

In modern times, business and other financial risks have increased greatly. Plaintiffs now use very sophisticated means to claim compensation from their debtors and those who have allegedly caused them loss. Some defendants have of course caused loss. They (or their insurers) should pay up. But others may not in fact be legally liable. Perhaps they have not been at fault. Or, if they have, their fault has not caused the loss, or not wholly. One of the functions of an efficient legal system is to distinguish, at reasonable cost and with reasonable expedition, the justified claim from the try-on. But the incidence of costs, costs-risks, opportunities to defend, and so on, all affect, to some extent, the effectiveness of a given legal system in this respect.

The problem is particularly acute (or at any rate perceived as such) in the USA.[2] There, the combination of contingency fees for plaintiffs' lawyers, high jury damages awards in civil cases, and the (general) absence of a "loser-pays-winner's costs" rule are considered to have tilted the balance significantly in favour of unmeritorious plaintiffs against meritorious defendants.

Professional indemnity insurance is not always available, and, when it is, it is very costly. Indeed, in the USA now it is often prohibitive, and more and more

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I am grateful to Professor David Hayton for comments on an earlier draft. However, he must not be taken necessarily to agree with what is written, and I am responsible for all remaining errors.

[2] See e.g., Osborne, 'Asset Protection for United States Clients', [1995] J Int P 12.

professionals are preferring to do without, so-called "running bare". For instance, it is estimated that between one fifth and one half of US lawyers carry no PI cover.[3] But, at the same time, such persons do not want the fruits of their labours put at risk of an enormous law suit, where the legal costs, never mind the damages, may ruin them.[4]

Many professional Americans seek to protect themselves by transferring assets to a limited partnership. Under US law this converts interests in assets attractive to creditors into interests in a partnership much less attractive to them.[5] If the partnership agreement is properly drafted, the creditor seeking to execute a judgment has usually been able to obtain no more than the distributions which the debtor would otherwise be entitled to. Meanwhile, the debtor continues to exercise the same control over the assets as before. But in recent years creditors have fought back, and now seek wider remedies, such as foreclosure and sale of the debtor's interest.[6] So limited partnerships are less popular than they were.

Limited liability in the full sense, by means of the limited liability company, is not available to all professionals, as some professional bodies may not allow their members to practise in this way. Thus, for example, English solicitors may incorporate their practices, but, unless the Law Society's consent is obtained, solicitors may only incorporate with *unlimited* liability. And if liability is allowed to be limited, the company must carry "top-up" insurance (i.e., over and above the maximum indemnity required for unincorporated practices), and shareholders must covenant to reimburse the Law Society in respect of payments made out of the Compensation Fund.[7]

Even when limited liability is achievable in theory, it often does not work in practice, as it can look unattractive from a marketing point of view, or personal guarantees may have to be given in many fields (e.g., for rent, bank overdraft and

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3 See Grundy, Briggs and Field, *Asset Protection Trusts*, 2nd ed 1993, para 1.4.

4 See further Bruce, Gray and Luria, 'Protection of Asset Trusts: Fallout from Litigation Explosion', *New York Law Journal*, 13th September 1991.

5 Engel, *Ideas and Trends*, Report 145, 27th January 1992; Engel & Rudman, *Trusts and Estates*, July 1993; Rudman and Lockwood, *CCH Financial and Estate Planning*, para 31,501 (November 1994).

6 *Crocker National Bank v Perreton*, 208 Cal App 3d 1 (1989); *Hellman v Anderson*, 233 Cal App 3d 840 (1991).

7 See the Solicitors (Incorporated Practices) Rules 1988, rr 9,13,14.

so on). Sometimes statute interferes.[8] In addition there may be other disadvantages, such as having to disclose profits and losses to competitors.[9]

Most legal systems impose limits on the types and (perhaps) amounts of assets of a debtor which can be taken in execution of a judgment, or which pass to a trustee in bankruptcy (or similar official) upon a debtor becoming bankrupt. But these limits are usually modest. In England and Wales, a court official executing a money judgment may seize and sell all the personal (but not real) property belonging to the debtor except clothing, bedding, furniture and household equipment and provisions for his own and his family's use, and tools, books and other equipment for use by him in his employment, business or profession.[10] And similarly, where a debtor becomes bankrupt *all* property belonging to the bankrupt vests in his trustee in bankruptcy, *except* tools, books, vehicles and other equipment necessary to the bankrupt to use personally by him in his employment, profession or vocation, and such clothing, bedding, furniture and other household equipment and provisions to satisfy the basic domestic needs of the bankrupt and his family.[11]

In the US the protected items vary from state to state. Thus, in Maine, the debtor's interest is protected in one boat not exceeding 5 tons burden. New York even protects a guide dog for the blind.[12] In some states (notably Texas and Florida) a debtor domiciled there may protect a primary residence (whatever it is worth) as a *homestead*.[13]

The laws of some jurisdictions relating to co-ownership of immovable property may also serve an asset protection function. Thus, under French law, land co-owned by two or more persons under a *tontine* arrangement (similar *in its effect* to a joint tenancy in English law) can only be made effectively subject to creditors' claims if the liability is that of all the co-owners jointly, or if they all so agree. If one co-owner becomes bankrupt, nothing can be done to force a sale of the property or otherwise to enable the creditors to realise the interest of the debtor.

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8 As in Jersey, Guernsey and elsewhere, where trust companies are concerned: Trusts (Jersey) Law 1984 Art 52; Trusts (Guernsey) Law 1988 s.70.

9 Though unlimited liability companies are in English law exempt from the requirement to file accounts and annual returns at the Companies Registry.

10 Supreme Court Act 1981 s.138(3A); County Courts Act 1984 s.89(1); in both cases the original statutes were amended by the Courts and Legal Services Act 1990 s.15.

11 Insolvency Act 1986 s.283(2).

12 Osborne [1995] J Int P 12, 18.

13 Mowbray and Field [1995] J Int P 3, 9.

This is because the property in fact belongs only to *one* of them — the survivor — and until the other or others die, *we cannot know who that is*.[14]

But all of these means of providing for or avoiding the claims of creditors are specific and partial. No-one buys unlimited professional indemnity cover, or puts their whole wealth in *tontine* clauses, or guide dogs. The hunt is on for a non-specific, general and universal solution to the problem. Some advisers think they have found the Grail, in the form of the Asset Protection Trust.

What is an Asset Protection Trust?

An Asset Protection Trust ("APT") is a trust intended to protect or preserve the assets of the settlor against his creditors or other persons who may have a claim on him. Thus the potential clientele of an APT includes (a) the entrepreneur about to start out on a potentially hazardous business, (b) the professional continuing to exercise a risky profession, and (c) the entrepreneur selling up, who wants not to be around if any of the warranties given are ever called upon.[15]

In addition, an APT can be adapted for corporate clients — such as multinational manufacturing and trading companies — who may be concerned about the risk of expropriation or confiscation of corporate assets in particular operating jurisdictions, for example if there is a revolution or if war breaks out and they are technically "the enemy". This is sometimes called a "Philips" trust, after the Dutch company whose assets were protected in this way from seizure by the US authorities during the Second World War. Needless to say, the complexities inherent in creating an appropriate trust vehicle for a large corporate body with worldwide operations and assets make the effort both very difficult *and* very expensive. But it is done. Corporate APTs are really outside the scope of this article, so I shall say no more about them now.[16]

In one sense, every trust is an asset protection trust. If it is fully effective, the assets held in trust are entirely cut off from the settlor's estate, and cannot be taken to satisfy the settlor's debts. It is what the French would call a *patrimoine affectée*. But when offshore trust practitioners refer to an APT they are being more specific.

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[14] See Dyson, *French Real Property and Succession Law*, 1988, 68.

[15] It does not much matter, today, whether the profession or business is to be carried on via the medium of a limited company: cf Osborne [1995] J Int P 12-13, and *Midland Bank plc v Wyatt* [1995] 1 FLR 696.

[16] See further, Schoenblum in McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations*.

An APT is a trust, but one with certain features. One such feature is that the settlor remains very much a beneficiary — if not *the* beneficiary.[17] He may have a life interest or other interest in possession, limited to come to an end in certain circumstances. In some jurisdictions[18] the settlor is not permitted, for reasons of public policy, to create a trust under which his interest will come to an end on his bankruptcy. Other jurisdictions are more sympathetic and permit such an interest to be reserved.[19] Or he may have a (defeasible) reversionary interest, which will fall into possession after a period of years which may be varied at the discretion of the trustees (or a protector), who may also have wide powers of appointment in favour of the settlor and his family. But whatever his beneficial interest, he will occupy a pivotal role in the *control* of the assets in question. This is at once the great attraction of an APT for a settlor, but (as we shall see) also potentially its downfall.

Another typical feature of the APT is that normally it is fully "offshore", i.e., the trustees, the governing law *and* the situs of the assets are all firmly out of the jurisdiction where the settlor carries or carried on his professional business. Although there is no necessity for these three to be located in the same jurisdiction, it is usual; and the jurisdiction is almost invariably a tax haven or low tax area, perhaps with special APT legislation like that dealt with later.

A further feature is that an APT usually contains power to change the forum, the governing law, the trustees and everything else very quickly; sometimes by "flee clauses" taking effect upon certain events occurring. Again, this is something dealt with later.

Relationship with Insolvency Law, Succession Law and Matrimonial Law

Most offshore trusts are specifically designed to deal with the tax law of the settlor's jurisdiction. An APT, by contrast, is designed to sidestep the *insolvency* law, and often the *succession* law and *matrimonial* law, of that jurisdiction. It is not usually designed to be tax efficient as well. At the same time some tax planning considerations can be taken into account.[20] This article looks at the APT largely from the point of view of English law, although certain other laws will be mentioned by way of comparison.

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17 See Osborne [1995] J Int P 12, 27-28.

18 Such as England, and some of the states of the USA.

19 See, e.g., the Belize Trusts Act 1992 s.12(4).

20 See, e.g., Citron and Steiner [1994] *Private Client Business* 96 at 98-100.

The settlor creates the APT to insulate assets from his creditors. Who are his "creditors"? We can characterise them by the nature of the relationship: business, personal, and family. Business creditors are those to whom the settlor owes money by virtue of his business activities, for example, clients, employees, his landlord. Personal creditors are those he owes money to by virtue of his domestic activities, for example, his doctor, his mortgagee or landlord, his bank. Family creditors are those to whom money is owed arising out of the family relationship, for example on divorce, or to whom assets must be left intact on death — so-called "forced heirship".

Each of the these types of creditor can fall into several time categories: present, potential and future. Each such category can be subdivided: "present" includes cases where liability is admitted as well as where it is denied; "future" includes cases where the settlor has current clients whom he thinks will come back to do business in the future, as well as clients he does not yet have; it also includes the case of the settlor who has not yet started up at all.

Who May Make Claims?

The persons who may make claims against trustees of APTs include the following:

(i) creditors of the settlor, who claim that the trust assets are liable to be taken in satisfaction of their debts;

(ii) members of the settlor's family, who claim indefeasible (or sometimes discretionary) matrimonial or succession rights;

(iii) the trustee in bankruptcy (or similar) of the settlor who has been made bankrupt, claiming to set aside dispositions made to the trust;

(iv) public authorities, who claim the assets disposed of as the proceeds of crime;

(v) the criminal prosecution authorities, who claim that an offence has or may have been committed in setting up the APT;

(vi) the settlor himself, if it should be determined that the APT is for some reason ineffective.

The nature of these claims needs to be expanded.

(i) *The creditors' claim to the assets*

Depending on the applicable law, this may be on any of several bases. The easiest is simply that under the terms of the trust the settlor retains a beneficial interest

(e.g., a percentage share or a life or reversionary interest) which is capable of being taken in execution of a judgment.

A second basis for the creditors to claim the assets is that the transaction is simply a sham, i.e., was never intended to alter the beneficial ownership of the assets, which continue to belong to the settlor, and again those assets can be taken in execution.[21]

A third basis is that the transaction creating the trust, though prima facie valid, is liable to be set aside, in whole or in part, as (for example):

(a) a fraud on creditors;

(b) made very shortly before insolvency supervenes;

(c) contravening public policy;

and thus, since the assets are not validly settled, they still belong to the debtor, and can be taken to satisfy judgment. In some jurisdictions such claims may be made directly by the creditors affected. In others, the creditors must seek the bankruptcy of the debtor and then leave it to the trustee in bankruptcy (or similar public official) to attack the transaction concerned.

The three cases mentioned can be amplified as follows:

(a) Transactions which are designed to defeat or to defraud the debtor's creditors. These are simply a matter of intention (which is of course more difficult to prove than pure arithmetic).[22]

What is defrauding your creditors? In England it was held over a hundred years ago that a settlement could be entered into to defraud creditors, not just where there were actual creditors, or

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21 See Hayton, 'When is a Trust not a Trust?' [1992] J Int P 3; Brownbill, 'When is a Sham not a Sham?' [1993] J Int P 13; Grundy, Briggs and Field, op cit, para 2.5; *Rahman v Chase Bank (CI) Trust Co Ltd* [1991] JLR 103; *Midland Bank plc v Wyatt* [1995] 1 FLR 696.

22 In England this category has existed since the Fraudulent Conveyances Act 1571 (13 Eliz I c.5, the so-called "Statute of Elizabeth"), and it is now governed by sections 423-425 of the Insolvency Act 1986. In the Irish Republic there is still the statute of Charles I (10 Car I, sess 2, c.3), which was modelled on the English Act of 1571. In Jersey there is the customary law, as in *Golder v Société de Magasins Concorde Limited* (1967) 1 JJ 721, exemplifying the Pauline action in Roman law. In Guernsey, see the *Loi ayant Rapport aux Débiteurs et à la Renonciation*, 1929, Art IX, and the Law of Property (Miscellaneous Provisions)(Guernsey) Law 1979 s.1(2).

even where there were *potential* creditors (i.e., persons with whom the settlor was dealing), but also where the settlor was proposing to embark on a hazardous activity, had not yet done any business, and had no future creditors in view at all.[23] This rule — usually known as the rule in *Re Butterworth* — was taken over by most of the British Commonwealth legal systems, though not all. Professional opinion in Jersey and Guernsey, for example, tends to take the view that it does not apply there, as inconsistent with the civilian idea of defrauding an *actual* creditor.[24] This is also the position in Scotland.[25] The US position appears to be intermediate between the English and the civilian.[26]

Again the use of the word "defraud"[27] does not necessarily mean proving fraud in the common law sense. It is enough that the settlor intended to make things more difficult for his creditors.[28] Indeed, recent English authority[29] (on the modern provisions which have replaced the Fraudulent Conveyances Act 1571, the so-called "Statute of Elizabeth") holds that prejudicing creditors need only be the *dominant* purpose of the transaction, not the *sole*

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23 *Mackay v Douglas* (1872) LR 14 Eq 106; *Re Butterworth, ex p Russell* (1882) 19 Ch D 588. See also *Stileman v Ashdown* (1742) 2 Atk 477. For similar views in relation to the equivalent modern English law, see *Chohan v Sagger* [1992] BCC 306 and *Midland Bank plc v Wyatt* [1995] 1 FLR 696 (where the debtor was proposing in future to trade through a limited company).

24 As to Jersey, see *Société des Magasins Concorde v Golder* (1967) JJ 721; as to Guernsey, see Allen, *Offshore Investment*, April 1995, 8 at 9.

25 Bell's *Commentaries*, 7th ed, vol 2, 180, 184; Erskine's *Institutes*, 8th ed, vol 2, 1066-1067; Menzies [1993] *Private Client Business* 127.

26 See Engel [1994] J Int P 105.

27 It appeared in the "Statute of Elizabeth", the Fraudulent Conveyances Act 1571, and the Law of Property Act 1925 s.172, but does not appear in the Insolvency Act 1986 s.423.

28 *Lloyds Bank Ltd v Marcan* [1973] 1 WLR 1387 at 1390 per Russell LJ; cf at 1392 per Cairns LJ; *Arbuthnott Leasing International Ltd v Havelet Leasing (No 2)* [1990] BCC 627; *Chohan v Saggar* [1992] BCC 306.

29 *Moon v Franklin*, *The Independent*, 22nd June 1990, *The Financial Times*, 26th June 1990; *Chohan v Saggar* [1992] BCC 306; see also *Midland Bank plc v Wyatt* [1995] 1 FLR 696 and *Royscot Spa Leasing Ltd v Lovett*, unreported, 16th November 1994, CA.

purpose. But the test of purpose is not completely objective, and the requisite purpose is not established merely by showing that the transaction in question was made for no consideration.[30]

(b) In some (usually civil law) systems the mere fact that a transaction takes place shortly before an insolvency supervenes is sufficient for that transaction, however proper otherwise, to be set aside.[31]

(c) Transactions contravening public policy. In England this will include those intended to ensure that the devolution of a debtor's property on bankruptcy will be different to that which the insolvency law provides: e.g., the debtor settles property upon himself for life determinable on his bankruptcy, remainder to his family, and so on.[32]

All these three bases involve *proprietary* claims, i.e., claims to assets which the trustee has. A fourth basis is infinitely more worrying to the trustee, because it involves his *personal* liability and is not limited to any assets which he may hold on trust. It will be a claim for conspiracy to defraud creditors, or perhaps for dishonestly assisting in a breach of fiduciary duty by the settlor (e.g., as a company director misappropriating that company's funds).[33]

(ii) *Claims by members of the family*

These may be claims on the settlor's assets under either the applicable succession law or the applicable matrimonial law. There may be *actual* rights (as under the so called "forced heirship" provisions in the law of many jurisdictions, including Scotland and — for spouses only — Ireland, or the community of property provisions of many laws, including France). Or there may be *potential* rights, e.g., as under the discretionary power of the English Court to make adequate

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30 *Royscot Spa Leasing Ltd v Lovett*, above.

31 In Jersey there is a good example of this in Article 52 of the *Loi (1880) sur la Propriété Foncière*, by virtue of which a disposition of immoveables within 10 days of the declaration of a *désastre* is void.

32 This is not possible under English trust law: see Underhill and Hayton, *Trusts and Trustees*, 15th ed 1995, at 184; *Official Assignee v N.Z.I. Life Superannuation Nominees Ltd* [1995] 1 NZLR 684; as to the US, see Hauser and Chapnick [1994] *Private Client Business* 378, 383.

33 See *Royal Brunei Airlines v Tan* [1995] 2 AC 296, PC.

provision for dependants.[34] As in England, the Court may have powers to set aside dispositions designed to defeat applications for provision.[35] Or the Court may even treat trust assets as "belonging" to one spouse and order the transfer of such assets to the other as part of a property adjustment order on divorce.[36]

Depending on the actual terms of the applicable rules, it is also possible that family members could claim to be "creditors" and make claims under (i) above.[37] This may be important if (as in England) there are strict time limits on claims made for family provision out of the estate of the deceased, and there are longer time limits (or none at all) under the insolvency legislation.[38]

The other basis for the relatives' claim would be that the transaction was a sham, and accordingly the assets concerned still formed part of the settlor's estate on his death. This is in effect what happened in the Jersey case of *Rahman*.[39]

(iii) *The trustee in bankruptcy's claim*

Again there are different bases for such a claim. First, the trustee in bankruptcy may make any claim which the settlor himself could have made, such as:

(a) any claim in right of a beneficial interest reserved to the settlor;

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34 Under the Inheritance (Provision for Family and Dependants) Act 1975, or for divorced spouses under the Matrimonial Causes Act 1973. Curiously, this is also the position in the civil law jurisdiction of Quebec, which has known freedom of testation since 1774, and discretionary post-mortem claims by dependants since 1989: Brierley and Macdonald (eds), *Quebec Civil Law*, 1993, 347-349. On the other hand, the Irish Succession Act 1965 abolished the freedom of testation which had previously existed, and replaced it by a mixture: a fixed right of one half for the surviving spouse (ss.111-112) and a discretionary power for the court to make "just" provision for children when "the testator has failed in his moral duty" to do so (s.117); see generally McGuire, *The Succession Act 1965, A Commentary*, 2nd ed 1986, Part IX (pp 238-289), and Brady, *Succession Law in Ireland*, 1989, ch 7.

35 See ss.10-13 of the 1975 Act and s.37 of the 1973 Act.

36 *Browne v Browne* [1989] 1 FLR 291 (English CA); *Cadwell v Cadwell*, unreported, 8th August 1989 (Royal Court of Jersey).

37 See *Cadogan v Cadogan* [1977] 1 WLR 1041, CA.

38 *Re Finn, ex p the Trustee*, unreported, 8th September 1992 (no limitation period under the Law of Property Act 1925 s.172), and see also the Limitation Act 1980 s.32(1)(a).

39 *Rahman v Chase Bank (CI) Trust Co Ltd* [1991] JLR 103.

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39 *Rahman v Chase Bank (CI) Trust Co Ltd* [1991] JLR 103.

(b) a claim that the transaction is a sham and that the assets still belong to the settlor.[40]

Second, the trustee in bankruptcy may be enabled by the local insolvency (or other) law to make *extended* claims, designed to bring back into the bankrupt settlor's estate assets which he had previously disposed of; this will vary from system to system, but may include:

(a) transactions at an undervalue (e.g., gifts);

(b) transactions intended to defraud creditors;

(c) transactions immediately before insolvency supervenes;

(d) transactions void for public policy, as, e.g., intended to alter the devolution of property on bankruptcy.

In some systems claims (b), (c) and (d) can be made directly by creditors. These have already been discussed under (i) above, and need not be repeated.

That leaves (a), transactions at an undervalue. These are cases where value flows out of the debtor's hands and nothing (or not enough) comes back, for example gifts.[41] In these cases we are not so concerned with the debtor's *intention* but instead with pure arithmetic.[42] Usually, however, there is a time limit, so that only transactions less than a certain time before the bankruptcy are capable of being impugned in this way.

(iv) *Claims by public authorities to the proceeds of crime*

These are claims made by public authorities to assets on the grounds that they represent the proceeds of crime, e.g., drugs, prostitution, protection rackets, fraud, gun-running, terrorism and so on. Many jurisdictions have legislation permitting

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40 Though quaere to what extent the settlor might be estopped from so claiming, and the trustee in bankruptcy likewise?

41 In England these are called transactions at an undervalue: see sections 339 to 342 of the Insolvency Act 1986; in Jersey there is Article 17 of the Bankruptcy (Désastre) Jersey Law 1990; in Ireland there is the — slightly different — Bankruptcy (Ireland) Amendment Act 1872 s.52.

42 See, e.g., *Re M C Bacon Ltd* [1990] BCLC 324 at 340; *Agricultural Mortgage Corporation v Woodward* [1995] 1 BCLC 1, CA.

the authorities to seize such proceeds and to trace them into the hands of third parties, such as trustees.[43]

(v) *Criminal prosecutions*

In some jurisdictions, attempts to defraud creditors also constitute a criminal offence. This was originally the position in England under the Fraudulent Conveyances Act 1571, and remains so in jurisdictions where that Act is still in force. Moreover, some jurisdictions have instituted new criminal offences that can be committed in circumstances connected with the setting-up of an APT.[44]

An even greater spectre for offshore trustees, however, is money-laundering, whereby the proceeds of crime are "cleaned-up" and appear as legitimate funds. Failure to report suspicion of money-laundering and similar activities is often made a criminal offence, as is taking part in the actual process of money-laundering.[45]

(vi) *The settlor*

The settlor has been persuaded to decant wealth into the APT on the basis that it will preserve assets against the claims of creditors. He is likely to be unhappy if a court subsequently holds that it does not do so, and he sees the depletion or destruction of those assets which he had hoped to avoid. He may therefore make a claim for negligence or breach of contract against the trustee, claiming that the trustee has not taken reasonable care to avoid causing loss, or that the trustee has failed to deliver the protection that he promised. At the very least this may involve a claim for all his costs, as well as for all the remuneration earned by the trustee.

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43 In the UK these provisions are contained in the Drug Trafficking Offences Act 1986 (drug trafficking) and Criminal Justice Act 1988 (proceeds of criminal conduct). For the recent recognition by a Jersey Court of a US forfeiture order, see *Re Representation Attorney General*, Jersey unreported, 16th January 1995, Royal Court.

44 The current offence in the UK is fraudulent disposal of property under s 357 of the Insolvency Act 1986. The burden is on the defendant to prove he had no intention to defraud or conceal the state of his affairs. In the USA, in addition to state laws making parties to a "fraudulent conveyance" guilty of an offence, there are various Federal statutes making concealment of assets in insolvency cases a criminal offence, and such offences may extend to professional advisers of settlors: see Grundy, Briggs and Field, op cit, paras 2.10.7-2.10.11; Hauser and Chapnick [1994] *Private Client Business* 378, 84-386; Mowbray and Field [1995] J Int P 3, 5-6.

45 See, e.g., the (US) Money Laundering Control Act (18 USC 1956 and 1957).

APT Legislation

A number of offshore jurisdictions have enacted legislation to encourage the use of APTs. Typically, this works by making it more difficult for the plaintiff to succeed in making good his claim against the defendant trustee in categories (i), (ii) and (iii), and removes any threat of seizure or criminal prosecution in categories (iv) and (v). Thus, assuming the safety of the trustee, the APT is likely to "work" and there will be no claim in category (vi).

The features of APT legislation that make claims (i), (ii) and (iii) less likely include the following:

(a) declaring that a settlor can confer on *himself* a life interest determinable on his bankruptcy;

(b) reversing the rule in *Re Butterworth*, so that future creditors are not "creditors" in considering whether creditors are defrauded;

(c) requiring a criminal standard of proof ("beyond reasonable doubt") of intent to defraud creditors before setting aside dispositions on such grounds;

(d) imposing short limitation periods (typically one or two years) from the date of a "suspect" disposition within which to bring a claim to set it aside;

(e) refusing to recognise or enforce judgments of other jurisdictions, either generally, or at any rate in the fields of bankruptcy, succession or matrimonial law;

(f) deeming persons who have no power or capacity under their personal law to make certain dispositions, or dispositions beyond a certain level (e.g., derogating from compulsory inheritance rights) nevertheless to possess such power or capacity for the purpose of making the disposition to the trustee in the trustee's jurisdiction.

These features do not appear in every offshore jurisdiction's APT legislation. Jersey and Guernsey, for example, have provision corresponding to (f)[46] and (impliedly at least) partially as to (e), but have as yet made no provision corresponding to (a)-(d) (although *Re Butterworth* probably does not apply there

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[46] Trusts (Jersey) Law 1984, Art 8A; Trusts (Guernsey) Law 1988 s.11A. The Isle of Man's new Trusts Bill (1995) would introduce similar provision into Manx law.

anyway).[47] On the other hand, the Cook Islands legislation includes all these features, and more besides.

It must be noted, however, that these legislative techniques for insulating APTs from challenge, although often included in an offshore jurisdiction's *trust* statute, are in fact concerned not so much with the operation of the trust, but with (i) the validity of the logically prior disposition of assets which gave rise to the trust and (ii) (in some cases) the validity of the particular kind of trust created.

The second of these is in some senses a "trusts" question (though many systems may not see it as such, preferring to look at it as part of a wider public policy issue). But the first is simply a matter of property transfer, having nothing to do with trusts as such. And, under generally accepted conflict of laws principles, the validity of the disposition (not being a transfer by operation of succession or bankruptcy law) will be judged, not according to the proper law of *the trust*, but according to the proper law *of the place where the property is*.[48]

So, if the APT legislation is to be fully effective, it must also have the effect of modifying so far as necessary the conflict of laws principles applicable in that jurisdiction so that the validity of the disposition is ensured, even though (say) the disposition took place elsewhere than in that jurisdiction, and on conventional principles that jurisdiction's law would not apply.[49]

Yet what is above all striking, amongst the various jurisdictions that have established statutory rules which can be regarded as APT legislation, is that there is so little unanimity amongst them as to how to deal with APTs. By way of example, let us briefly compare the creditor protection rules relating to trust creation in a number of offshore jurisdictions.

In the Cook Islands, the International Trusts Act 1984 (as amended) provides that a disposition to an international trust simply shall not be voidable in the event of the settlor's insolvency, *unless* a creditor whose cause of action accrued in the two years *before* the settlement was made and who has commenced proceedings against the settlor in respect of that cause of action before the expiration of one year *after*

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47 See note 24 above.

48 See, e.g., Dicey & Morris, *The Conflict of Laws*, 12th ed 1993, vol 2, at 965-978; Collier, *Conflict of Laws*, 2nd ed 1994, 242-249, and cases there cited.

49 The Cayman Islands Trusts (Foreign Elements) Law 1987 s.5 expressly does this; Bermuda's Trusts (Special Provisions) Act 1989 does not, though in *Garner v Bermuda Trust Co Ltd*, noted [1992] J Int P 51 (first instance) and 113 (appeal) the Bermuda courts treated it — erroneously in David Hayton's view — as though it did.

the settlement was made, proves *beyond reasonable doubt* that the principal intent of the settlor in creating the settlement was to defraud that creditor. That is a very tough test indeed to satisfy.[50]

In the Cayman Islands (Fraudulent Dispositions Law 1989), The Bahamas (Fraudulent Dispositions Act 1991), and Anguilla (Fraudulent Dispositions Ordinance 1994), legislation very different from the Cook Islands, but practically identical to each other, has been produced. In these jurisdictions, every disposition of property (not just into trust) made with intent wilfully to defeat a liability (actual or contingent) existing at the time of such disposition owed to another person is voidable within a certain period at the instance of that person if he is thereby prejudiced. In Cayman the critical period is six years; in Anguilla it is three years and in The Bahamas it is only two years. This is rather less tight than the Cook Islands legislation, but it still means that a *Re Butterworth* future creditor will not be able to set aside a trust created before his liability came into existence.

In Gibraltar, the test of intention is abandoned altogether. There, by virtue of the Bankruptcy (Amendment) Ordinance 1990, a disposition to a trust is voidable at the instance of a creditor (actual, contingent or prospective) if the settlor is insolvent at the date of the disposition or becomes insolvent by virtue of such disposition. But, for this purpose, a person is not a creditor *unless* the settlor then has actual notice of the creditor's claim, or of facts or circumstances which might render him liable to such claim, and "insolvent" means that a settlor's liabilities of which he has notice exceed the value of his assets. This would appear to exclude the *Re Butterworth* future creditors, but it could have been put more clearly.

In the Turks & Caicos Islands, the legislation (contained in the Trusts Ordinance 1990) is similar to that in Gibraltar. If an individual makes a transfer into trust, and he is not insolvent at the time of the disposition, or rendered insolvent by the disposition, then the disposition shall not be voidable at the instance of any creditor of the settlor.

In Cyprus, the International Trusts Act 1992 creates a new regime for Cyprus-based trusts for foreigners. Broadly, an "international trust" (as defined) can be set aside as a fraud on creditors if such creditors institute action within two years from the transfer of assets into trust, and the burden of proving intent to defraud rests on the creditors so alleging.

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[50] It is said that the Cook Islands APT legislation was drafted in conjunction with US lawyers, seeking to address largely US concerns. It is notable that this legislation on its face appears to deal with more of such concerns than any other offshore jurisdiction of which I am aware.

In Mauritius, the Offshore Trusts Act 1992 makes similar provision for "offshore trusts" (as defined) to be set aside as fraudulent by creditors' action within two years from the transfer into trust, but, unlike Cyprus, the creditors have the burden of proving this *beyond reasonable doubt* (the higher standard of proof, as in the Cook Islands).

In Belize, by virtue of the Trusts Act 1992,[51] it is provided that a Belizian court cannot set aside a Belizian trust, nor recognise the validity of any claim against the trust property, pursuant to the law of another jurisdiction or the order of a foreign court in respect of marriage or divorce, succession or claims by creditors in an insolvency, notwithstanding the law relating to fraudulent transfers, the Bankruptcy Act and the Reciprocal Enforcement of Judgments Act. This is probably the most self-contained rule of all. The Belize rule has been copied by Niue in its Trusts Act 1994.

In Bermuda, the Conveyancing Act 1983 was amended in 1994 to render voidable any disposition made with the dominant intention to put property beyond the reach of a person who is making or may at some future time make a claim. The persons who may seek to avoid the disposition are (a) a person then or within two years afterwards owed an obligation; (b) a person then owed a contingent liability which has since matured; (c) a person owed an obligation from a cause of action accruing before the disposition or within two years thereafter. But a test of reasonable foreseeability is imposed in respect of contingent and future creditors, and there is a limitation period of six years for claiming to set aside a disposition. These are by no means to be regarded as "aggressive" APT rules, although they certainly represent a considerable retreat from the common law position.

In comparing these different forms of APT legislation, one can sometimes sense a certain desire to "trump" competitors, a sense of pride in having the most creditor-resistant position. This is understandable. But there is a downside. If in legal proceedings it becomes necessary to determine what was the settlor's predominant motive in creating the trust, there is a danger that the *identity of the offshore jurisdiction itself* will become a factor, *because* of the strength of the APT legislation. "If," the creditor or the trustee in bankruptcy will say, "you the settlor were only carrying out an exercise in estate planning — and not intending to avoid creditors' claims — why did you go to the distant island of Utopia (where we note that there is aggressive APT provision) instead of the nearby island of Ruritania (where there is less or none at all)?"

This is not merely a forensic point. The very existence of differences in the range of offshore jurisdictions means that a conscious choice is being made. The consumer of apples need not be sophisticated. He has in any event to eat. Choice can often be an accident. But the consumer of offshore trusts is different. You

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[51] Apparently drafted by English counsel.

do not need an offshore trust to live, and you do not acquire one by accident. You (or your advisers) will be sophisticated in entering the market and making a selection. And your choice may come back to haunt you.

Why Offshore?

When a settlor creates a trust intended to protect assets, there are three particularly important variables:

(i) where the trustees (and protector, if there is one) are based;

(ii) what law governs the trust;

(iii) where the trust property is.

In each case the settlor may select his home jurisdiction, or he may select a foreign ("offshore") jurisdiction. In practice, he *minimises* the "protective" quality of his trust if all three variables are "home", and he *maximises* it if they are all "offshore".

First, since the trustees are the persons legally entitled to control the trust assets, any challenge to the validity of the trust will involve them. If they are also in the settlor's home jurisdiction the courts of that place will have little difficulty in invoking their jurisdiction and (if the challenge succeeds) ordering the trustees to retransfer the assets or surrender control. If they do not comply they can be fined or imprisoned, and a court official can be appointed to execute any necessary documents.[52] But if they are out of the settlor's home jurisdiction, they will obviously be more difficult to get at. Similarly with any protector.

Second, the law governing the trust may make a challenge to the trust more or less difficult. It may do this by modifying (or at any rate purporting to modify) conflicts of laws principles so that the initial disposition is governed by *its* law rather than another which would be indicated on conventional principles. Or it may permit the creation of a form of trust (e.g., protective trust *for the settlor*) which the settlor's own law would forbid. Or it may restrict rights to information about the trust (or permit the settlor to do this), so that any challenge is more like fumbling in the dark than fighting in the open.[53]

Third, if the trust assets are physically present in the settlor's home jurisdiction, the risk is increased of the courts of that jurisdiction simply ignoring or bypassing

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[52] See note 64 below for the English rules on this.

[53] See note 73 below.

the trustees and the proper law of the trust, and making and enforcing *in rem* judgments against the assets. After all, at the end of the day, the property itself is what the argument is all about.

The technique of leaving the assets "at home" but appointing offshore trustees and using a foreign proper law (so-called "importing the law") has been popular in the past in the USA, especially when the settlor's wealth was still tied up in a US-based business. But it is obviously less safe than "exporting the assets" and making all three of the variables "offshore".

Which Jurisdiction?

Plainly the selection of an appropriate offshore jurisdiction in which to establish an APT involves balancing a number of different (and competing) factors.[54] One of these will be the number and quality of the features present in the APT legislation. However, it is necessary not just to look at the *text* of the law, but also at how it is likely to work in practice. The integrity of the local legal profession, the speed and effectiveness of the procedures in the legal system, the probity and intelligence of the judges, all these matter, too, in considering what amounts to "the law" in a given place.

In this connection, it must be borne in mind that very little of the APT legislation under discussion has so far been tested by the appropriate courts in litigation to see if it has the effect intended by the legislators.[55] As to this, it is worth remembering that for most of these territories the ultimate court of appeal is the Judicial Committee of the Privy Council in London, whose judges are mostly the same as those in the House of Lords. They, being senior English judges of perhaps more conservative outlook, and being far removed from the offshore trust world, may not *necessarily* take the same liberal view of legislation designed to restrict creditors' rights as those who created it.[56]

In addition, there are the non-legal features: time-zone, communications (physical and electronic), language and culture, expense. All will play a part. If the difference in time zones means that you can only communicate directly during a one-hour "window" each business day, or even only indirectly, by overnight fax, this may cause difficulty. If they do not speak your language *as you speak it*, that may also do so.

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54 See, e.g., Venables, *Non-Resident Trusts*, 5th ed 1993, ch 5; Osborne [1995] J Int P 12, 28-30.

55 cf *Garner v Bermuda Trust Co Ltd*, noted by Hayton [1992] J Int P 51, 113.

56 See Clarke, 'The Privy Council, Politics and Precedent in the Asia-Pacific Region'(1990) 39 ICLQ 741.

Multiplicity of Jurisdictions

We have seen that the strongest protection is obtained when the trust, trustees and assets are all fully offshore, perhaps in a jurisdiction with special APT legislation.

But claims may be made against the trustees in more than one jurisdiction. In addition to the trustees' "home" jurisdiction, a claim may be made also in the settlor's "home" jurisdiction, or in any third jurisdiction, depending on the local rules for when a claim may properly be made. And in such other jurisdiction, there may well be no helpful APT legislation to protect the trustees. For example, in England and Wales the jurisdiction of the court originally depended on the physical presence (even temporary) of the defendant in England and Wales at the time of service of the proceedings, and this is still the basic rule today,[57] though there are now other bases for jurisdiction as well.[58] In some places, jurisdiction may be founded on the mere presence[59] — or at any rate the arrest[60] — of assets within the territory concerned. Or jurisdiction may be founded — as in France — on the (French) nationality of the plaintiff, who wishes to sue a foreigner, *wherever* he is, in the plaintiff's national courts.[61]

Moreover, the English courts have held that some at least of the powers to avoid transactions prejudicing creditors extend to persons resident outside the jurisdiction with no place of business in the UK, provided that there is sufficient connection with England to make it proper to make such an order.[62] However, jurisdiction to make a bankruptcy order against a settlor is more restricted, and requires either domicile or personal presence in England and Wales when the petition is presented, or residence or carrying on business there within the previous three years.[63] And criminal jurisdiction is exercisable in practice (whatever the theoretical position) only when the defendant is present to be charged.

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57 This rule is of course restricted by the provisions of RSC Ord 11 and by various conventions — notably the Brussels and Lugano Conventions — where they apply.

58 See RSC Ord 11 r 1(1).

59 As in, e.g., Austria and Sweden (where it is sometimes known as "the umbrella rule" because a foreigner has only to leave his umbrella in a Swedish restaurant for Swedish courts to have jurisdiction).

60 As in Scotland: Walker, *Principles of Scottish Private Law*, 4th ed, 1988, 159.

61 *Code Civil*, Art 14. Identical rules, *mutatis mutandis*, apply in Belgium and Luxembourg.

62 *Re Paramount Airways Ltd* [1993] Ch 223, CA.

63 Insolvency Act 1986 s.265.

By contrast, it should be relatively straightforward to persuade the trustees' "home" jurisdiction to hear a claim *against them*. But it may not be so easy to persuade it to entertain a bankruptcy application *against a settlor* who otherwise has no connection with that place. And a bankruptcy order will be needed before a trustee in bankruptcy is appointed.

However, it must be borne in mind that, where a court has jurisdiction over a person, it may not only make orders that that person *do* a thing (such as execute a deed or other instrument), but also, in default of the defendant doing what he is ordered, may order *another* person (typically a court official) to do the particular act on behalf of the recalcitrant defendant.[64]

Thus a well-run APT will not only keep the trust assets in a different jurisdiction from the settlor, but will be made on terms permitting the foreign controller or custodian of the assets to refuse to recognise the directions of a foreign court or its nominee, or of any person (e.g., the settlor, or a protector) they consider to be acting under duress.

Recognition of foreign judgments and orders

But it is not just judgments and orders of the courts of the trustees' home jurisdiction that they will fear. They will also fear judgments and orders of the courts of *other* places which are recognised or enforced by their "home" courts. In modern times this question is increasingly governed by international conventions, whether bilateral or multilateral. In the UK, for example, there are the Administration of Justice Act 1920, the Foreign Judgments (Reciprocal Enforcement) Act 1933, the Brussels Convention 1968 and the Lugano Convention 1988.[65] There are also agreements on co-operation in insolvency, particularly between member states of the Commonwealth,[66] and in criminal law matters.[67]

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64 (England and Wales) Supreme Court Act 1981 s.39; *Astro Exito Navegacion SA v Southland Enterprise Co Ltd (No 2)* [1983] 2 AC 787.

65 The last two were given the force of law in the UK by the Civil Jurisdiction and Judgments Act 1982, as amended by the Civil Jurisdiction and Judgments Act 1991.

66 See, e.g., the Insolvency Act 1986 s.426, and the Co-Operation of Insolvency Courts (Designation of Relevant Countries and Territories) Order 1986, SI 1986 No 2123, designating a number of Commonwealth countries, and also the Republic of Ireland.

67 In the UK see the Criminal Justice (International Co-operation) Act 1990.

APT legislation can of course make special provision in respect of these rules as well. It can provide that the local courts (i.e., of the trustees' "home" jurisdiction):

(a) will not recognise or enforce judgments or orders purporting to set aside dispositions to local trustees or otherwise giving effect to claims against trustees (or settlors, for that matter);

(b) will not give any assistance to a trustee in bankruptcy, or similar official, appointed by a foreign court.

Again, there are a number of offshore jurisdictions (such as Belize, the Turks & Caicos and the Cook Islands)[68] whose APT legislation incorporates such features. Not surprisingly, such jurisdictions are not designated by the Commonwealth insolvency co-operation legislation, mentioned above.[69] Some jurisdictions, such as Liechtenstein, are notorious for never assisting foreign trustees in bankruptcy.

But once more it must be noted that this will only protect the trustee (if at all) in his own home jurisdiction. If he should stray abroad, or if he has assets abroad (whether of the particular trust or not),[70] he may find himself subject to legal proceedings, judgments and orders, and arrests and sequestrations pursuant to another, less kindly law. Offshore trustees holding assets denominated in US dollars, for example, may find their (or their parent company's) US dollar accounts in New York frozen as part of US-based litigation.

Moreover, even if the local legislation protects the trustee in his home jurisdiction against recognition and enforcement of foreign court *orders*, it must be a separate matter (probably one of construction) whether it offers the same protection against recognition of otherwise private acts done in the "other" jurisdiction which (according to the law of that jurisdiction) have the effect of altering the property or other rights of the settlor/debtor.[71] This is particularly important where the

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68 Indeed, the Turks & Caicos and the Cook Islands have no bankruptcy legislation at all.

69 See note 66. Some offshore jurisdictions with APT legislation, such as The Bahamas, the Cayman Islands, Gibraltar and the Turks & Caicos Islands, are so designated, but this only means that the UK courts will respond to their requests, not vice versa; cf Lawson (1993) 3 OTPR 93 at 98-99.

70 A particular problem in non-trust states, which see only common legal ownership, and not different beneficial ownerships.

71 See note 49 above.

law of the "other" jurisdiction permits the local court to order a person other than the settlor/debtor to execute documents and carry out transactions on his behalf.[72]

Implications for APT Trustees

What this means is that a trustee of an APT has at all times to keep in mind three distinct possibilities, and the substantive and procedural law that goes with each of them:

(1) the trustee may be sued out of his home jurisdiction, under both substantive law and procedure very different from his own;

(2) the trustee may be sued in his own jurisdiction, under his own substantive law and procedure;

(3) a combination of (1) and (2) — the trustee may be sued away from home, and any judgment thereby obtained may be sought to be enforced in his own jurisdiction.

Moreover, even where it might be thought that the various mechanisms incorporated into APT legislation offered sufficient protection (and it must be remembered that none protects against claims of "sham"), plaintiffs may still bring more or less speculative claims. This is particularly likely in jurisdictions where contingency fees for lawyers are permitted, where there are no costs awards to successful defendants to deter "no-hope" plaintiffs, and there is the possibility of very high money awards (e.g., because damages are determined by a jury).

The "common-law" jurisdictions' procedures also involve another serious problem for trustees, and that is the process known as discovery. A claim to set aside a trust for infringement of one or more of the rules already discussed must be based on *information* presented by the claimant, tending to establish the breach. It is true that, in some jurisdictions, there may be evidential presumptions to assist, but the principle is clear. Where will the claimant get the information? Some will be available to creditors, or trustees in bankruptcy, in the debtor's jurisdiction, e.g., in the form of rights to examine the debtor or take possession of his papers. Other information may be available *through* the debtor, e.g., his right to information

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[72] See note 64 above, and *Blum v Bruce Campbell & Co* 1992-93 CILR 591.

about the trust by reason of being a beneficiary. This will be important to start with.[73]

But in the litigation context the most important source of information will be the compulsory procedures known collectively as "discovery". In the US this is wide-ranging and of great importance.[74] In England and other common law jurisdictions it is not so invasive, but a determined plaintiff can get a lot more information, and hence further along the path to success, than might be thought.[75] A professional trustee also has to consider the effect of fighting large scale litigation on (i) the running of the existing business, (ii) keeping existing business, and (iii) getting in new business.

So what can a trustee in such a situation do to protect himself?

(1) He can take indemnities from the settlor and (perhaps) the beneficiaries, preferably supported by a charge or other security on the assets, although this will only be as good as the settlor's title to those assets;

(2) He can obtain affidavits or sworn statements from the settlor as to his financial and other circumstances at the time of making the disposition, and as to the provenance of the funds being settled; he should also make his own "due diligence" enquiries;

(3) In some jurisdictions[76] the settlor can obtain a certificate of solvency which is strong evidence — even conclusive — of that fact, and hence block one line of attack;

(4) He may ensure that the settlement confers power on him in specified circumstances to appoint *the settlor* to be trustee in his place, and thus throw the monkey onto his back (though under certain laws he might still

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[73] Though some APT jurisdiction legislation may seek to interfere here, by restricting the information available to beneficiaries, or to beneficiaries who have become bankrupt. This may be backed up by criminal sanctions against unauthorised disclosure of trust information. Or the trust deed itself may purport to restrict or even exclude beneficiaries' rights to information: *Tierney v King* [1983] 2 Qd R 580; cf *Jones v Shipping Federation of British Columbia* (1963) 37 DLR (2d) 273 at 274-275; *AG of Ontario v Stavro* (1994) 119 DLR (4th) 750.

[74] See Hauser and Chapnick [1994] *Private Client Business* 378, 386-393.

[75] See *Lemos v Coutts & Co* 1992-93 CILR 460 (Cayman CA).

[76] e.g., Gibraltar.

have a personal liability: cf dishonest assistance in a breach of fiduciary duty in English law);[77]

(5) He might (again in specified circumstances) appoint all the assets out to the settlor, effectively rendering academic a dispute as to the validity of the initial disposition and simultaneously rendering it less likely (a) that he will be pursued at all, and (b) that there will be any loss for which he can be liable.

Change of Situs

An important part of any discussion of APTs is the question of changing the situs of a trust. This question may arise in two ways: first, in turning an existing trust which does not provide sufficient protection for assets into an APT by moving it to a more favourable jurisdiction; and second, as part of asset protection itself, by enabling an APT in certain circumstances to uproot itself and move to another jurisdiction (or series of jurisdictions), thereby rendering it a more difficult target.[78]

When we speak of the *situs* of a trust, we are usually referring to the place of residence or business of the trustees, rather than to the place where the assets are, or the place whose law constitutes the governing, or proper, law. This is because we usually need to know the situs for tax reasons, and usually (in the UK) that depends on residence of the trustees, and the place of administration.[79] In changing the situs of a trust we are therefore primarily referring to changing the trustees' residence or place of business, although it is commonly (though not necessarily) the case that the situs of the trust assets and the proper law will also change at the same time.

The usual way to change the trustees' residence or place of business is for the old trustees to retire in favour of new trustees in the new situs. There are broadly two ways in which this can take place:

(1) automatically, on certain defined events taking place;

(2) as a consequence of the exercise of a power to do so, whether exercised by the trustees, the settlor, or some other person.

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[77] *Royal Brunei Airlines v Tan* [1995] 2 AC 296, PC.

[78] See generally, Matthews, *Emigrating Trusts*, 1990.

[79] See generally, Venables, *Non-Resident Trusts*, 6th ed 1995.

Provisions in trusts which *automatically* retire old new trustees and appoint new ones are sometimes called "flee clauses".[80] In such cases, it is necessary to be very precise as to the "trigger" event, for you do not want there to be any doubt as to whether or not it has taken effect. A major difficulty is that it is not easy to be precise in advance as to the exact circumstances in which the automatic emigration should take place. When, some years ago, the Governor General of Bermuda was assassinated, some hundreds of trusts were automatically exported because they contained "flee" clauses drafted in sufficiently wide terms to cover the event. Were any Guernsey trusts automatically exported when Guernsey was blockaded a couple of years ago by French fishermen protesting at their exclusion from particular fishing grounds?

On the other hand, a mere power to retire trustees and appoint new ones is also problematic. First is the question, Who should exercise it? If there is a revolution — or a natural disaster — persons within the jurisdiction concerned may not be in a position to exercise powers, or to communicate with the outside world about them. But if the settlor has such power, he may well (particularly if he has other powers in relation to the trust) be regarded by revenue and other governmental authorities as controlling the trust, even to the extent that the trust is regarded as his alter ego. In asset protection terms, such a conclusion can be fatal.

Often, therefore, the power to remove and appoint trustees is vested in a third person, sometimes known as the "Protector"[81] or "Appointor" of the trust. The label applied is immaterial. The important thing is that this person should be kept well informed of what is going on, so that he can decide very quickly whether to exercise his power.

Appointing the trust assets into another trust is a favoured technique in asset protection planning. The trustees do not move, but the assets do, leaving one trust and joining another.[82] In such a case the existing "foreign" trust typically has merely a nominal value until the assets from the original trust are decanted into it. It is sometimes referred to as a "pilot" trust, and can be of considerable assistance in relation to asset protection. Indeed, one could imagine a chain of "pilot" trusts stretching from jurisdiction to jurisdiction. It can be employed automatically (as with "flee clauses") or on the exercise of an express power.

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80 See generally, Hendrickson and Silverman, *Changing the Situs of a Trust*, para 12.05.

81 See Rosen [1995] *Private Client Business* 36; Conder, *Trusts & Trustees*, March 1995, 12; Underhill & Hayton, *Law of Trusts and Trustees*, 15th ed, 1995, at 23-25.

82 See, e.g., *Richard v MacKay*, unreported, 4th March 1987, Millett J (see (1991) 1 OTPR 1)

Changing the Proper Law

It is often considered desirable, when a trust migrates from one jurisdiction to another, that its governing — or proper — law should change to that of the new jurisdiction. This is usually put on grounds of convenience and sense of security for the new trustees, who will be more used to the new law than to the old, and hence resulting in time and cost savings, since foreign lawyers will not constantly need to be consulted. There may occasionally be something in such arguments; in today's international trust marketplace, with transnational professional contacts and instantaneous communications, such arguments are generally overrated.

It is, however, accepted in most Anglo-Saxon trust systems that it is possible to change the proper law of a trust.[83] What remains unclear is the effect of so doing. Thus, if all the beneficiaries (and potential beneficiaries) being of full age and sound mind approve the change, and so does the court under variation of trusts legislation, on behalf of those who being minors or unborn cannot do so, then the proper law is changed, and it *appears* that the effect is to create a new settlement. The proper law can also be changed, it appears, by the exercise of a special power in the trust in that behalf, or by a similar provision expressed to take effect automatically on the happening of certain events (i.e., the parallel of the "flee clause"). Another possibility is the exercise of a special power of appointment to appoint assets into an existing or new trust subject to a different proper law. This is a technique discussed above in connection with the change of situs of a trust, but it can apply just as much to changing the proper law.[84]

The major difficulty with the notion of changing the proper law of a trust is to be sure of the effect it may have upon the interests of the beneficiaries. Suppose, for example, that a life interest determinable on bankruptcy is valid under the law of X, but void (as against public policy) under the law of Y. If a trust for A for life determinable on his bankruptcy with remainder to B is originally governed by the law of X, it is valid. But if, whilst A is alive and solvent, the proper law is changed to that of Y, under which A's interest is void, what happens? Whether A's interest is extended to his death, so that the bankruptcy condition is ignored, or there is a resulting trust until A dies or becomes bankrupt, or B's interest is immediately advanced into possession, an immense change has been wrought to the beneficial interests under the trust.[85]

This may cause significant technical problems, e.g., in regard to the rules against perpetuities or against excessive accumulations. Thus, a trust which otherwise

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[83] See generally, Matthews, *Changing the Proper Law of a Trust*, 1990.

[84] See Matthews, *op cit*, section 5.

[85] See Matthews, *op cit*, section 7.

complies with the technical rules (and hence would be valid) may by reason of the mere *existence* of a power to change the proper law contain power, without anyone realising, so to alter the beneficial interests as to transgress those technical rules (and hence to cause the trust to fail, in whole or in part).

What is perhaps worse is that significant tax liabilities may lurk in the background behind the mere existence of powers to change the proper law. Suppose a tax system, like that of the UK, provides that if a settlor retains even the slightest possibility of benefiting under the trust he is taxed on the entire income of the trust, even though he actually receives not a penny of that income. Thus, if there is a power to change the proper law, in a given trust, and if it is possible to find at least one foreign legal system by reference to which even one of the interests should fail, causing a resulting trust to arise for the settlor, then there must be a danger that the revenue authority will seek to assess the settlor with tax on the trust's income, though the power to change the proper law is never exercised, and the settlor never receives any of the income. Of course, in APTs the settlor generally intends to retain an interest — usually a dominant interest — and hence this particular tax problem does not arise as such, but the principle of the matter is clear: the effect in technical and tax terms of having a power to change the proper law, much less exercising it, must be carefully evaluated in all the circumstances, and if it is to be included then such a power must be restrictively drafted so as to avoid the worst of the problems.

Position of Beneficiaries

Beneficiaries under APTs are of two kinds: settlors and others. By and large, settlors expect to be the principal beneficiaries and controllers of what goes on in the trusts. They are professional or business people, making money, used to giving instructions, and being in charge. The very idea that someone whom they have instructed, *and pay*, a mere lawyer or accountant at that, is somehow in charge of their assets, and can ignore their instructions, is not something that they will easily accept. Worse still is the idea that other "beneficiaries", even their children or other relatives, might have any rights.

But the more the settlor controls in fact, the less likely the trust is to be genuine, and then it does not matter *which* jurisdiction you choose. It will be a sham anyway, and liable to be set aside as such. Structures can be created which may offer at least partial protection against the complaint of sham. Suppose that the settlor's assets are settled, and then the trustees enter into a partnership with the settlor to carry on the business: 98% for the trustees, 2% for the settlor, with the settlor being the managing partner. The settlor retains control. But although that might explain control by the settlor of the business assets in daily use (i.e., buying or selling and so on), it does not explain control of the distribution of benefits, capital and income. If the distribution of benefits is controlled by the settlor, the whole trust looks like a sham anyway.

Another aspect of the beneficiaries' position is the difficulty of their enjoying the benefits if the settlor is currently under insolvency attack. If the trustees give him money or other property, then this will be taken by the trustee in bankruptcy or equivalent. The trustees will have to find ways to benefit the beneficiaries that do not produce assets for the creditors. For instance, the trustees might pay for a world cruise for the settlor,[86] or settle his hotel bill (assuming he can still get credit). At all events, it is not easy to benefit an insolvent beneficiary and stay on the right side of the ethical and legal line.

Do APTs Work?

It might be thought that, with all the technical and other difficulties involved in the creation of an APT in the narrow sense, no-one would bother. Yet they do. Whilst, understandably enough, precise numbers are not available, there is no doubt that very many settlors have been sufficiently motivated to create APTs for the dominant purpose of sheltering assets from actual or potential claims. At an academic level, to ask if such trusts "work" is almost meaningless. Whatever the theoretical position, most of them will never be challenged, let alone set aside. At a practical level, one could say that an APT "works" if the settlor is better off than if he had never created it. In this connection it must be borne in mind that such trusts have "up-front" legal and other establishment costs, and significant annual running costs. The assets to be protected have to be worth spending this money on. Many offshore trustees will not take on trusts worth less than US$1 million.

Although the evidence is by its nature largely anecdotal, and usually provided by those whose interest it is to provide positive evidence, there is little doubt that in this sense they *do* "work" in most cases. Potential plaintiffs never sue at all, or (if they do) are bought off for a fraction of what it would cost if the assets were held by the settlor personally.[87] Only the most determined (and usually well-off) plaintiffs break through.

Position of Professionals Involved

This brings us to the question of the professional advisers involved. It is clear that, although the basic concept of an APT is simple enough, the various flavours and strengths available are very much open to debate and individual choice. From

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[86] cf *Re Coleman* (1888) 39 Ch D 443 at 451; but see *Twopenny v Peyton* (1840) 10 Sim 487.

[87] See, e.g., *The Economist*, 5th October 1991, reporting that one US law practice, having 400 APT clients, had defended 24 cases, all settled out of court for about 15% of the original claim; see also Engel, *Offshore Investment*, April 1993, at 28.

the point of view of professionals involved (accountants, lawyers, bankers, trustees), they must be *very* careful as to what they promise to their clients. If they promise such-and-such a level of insulation, can they deliver it? If they cannot, they run the risk of a claim by their settlor, a claim which might ultimately result in their becoming the effective insurer of the professional or business activities of a client that perhaps they did not much like the look of in the first place. And, in a more serious case, an adviser could come under personal liability to the creditors who have been prejudiced by the settlor's actions. If the settlor had the relevant intention to "defraud" creditors, the adviser may have had it too, and may be liable for conspiracy, or worse.[88]

Then there is the criminal law. We have already mentioned the possible criminal liability of the settlor himself. Those who advise and assist him, if he acts in a criminal manner, may themselves be guilty of criminal conduct. In England this might constitute the offence of conspiracy to commit,[89] or of aiding and abetting, counselling and procuring[90] the commission of, the principal offence.[91] Moreover, an adviser who falls foul of the criminal law (whether relating to bankruptcy, money-laundering or whatever) of the settlor's home country, may be subject to extradition there from his own jurisdiction.[92] Even if he is not, he will find his freedom of movement significantly curtailed. And, in some small jurisdictions, this could be irksome.

Of course, advisers cannot be responsible for the actions of those clients who, having asked if X is lawful or not, and being told that it is not, go ahead and do it anyway. Nor can they be blamed if clients ask whether there is any lawful way round such-and-such a law, and the professional's honest opinion is that there is. There can be no difference here between advice on tax, crime, or insolvency law. Nor are professionals wrong in trying to help those who have already done something to show (if they can) that it was not wrong. It is for the judge and not the lawyer to decide what is within and what without the law, and, as Dr Johnson said, what does not convince the lawyer may yet convince the judge, and, if it does, why then the judge is right and the lawyer wrong.[93]

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88 See Citron and Steiner [1994] *Private Client Business*, 96 at 101; and correspondence at ibid, 239-241; *Adams v The Queen* [1995] 1 WLR 52, PC.

89 Criminal Law Act 1977 s.1; Criminal Justice Act 1987 s.12.

90 Accessories and Abettors Act 1861 s.8, as amended.

91 See note 44 above.

92 As to the relevant UK law, see the Extradition Act 1989.

93 See Boswell's *Johnson*, Vol 1, 341; see also *Johnson v Emerson* (1871) LR 6 Ex 329 at 367, per Bramwell B.

Conclusion

In this short survey we have not been able to consider every interesting point that arises in connection with APTs. We have, however, seen the basic principle in action, and we have seen how certain offshore jurisdictions have set up their stalls in the market place with all different kinds of statutory offerings for the businessman or professional adviser to inspect.

How far should professionals be involved in this kind of work? The APT world is yet young, and the legislation practically untested. There is much to be said for looking at the experiences of others, before professionals jump in with both feet and find themselves up to the neck in the kind of work which perhaps they would rather not have. On the other hand, a professional cannot stick his neck in the sand, ostrich-like, and pretend that it is impossible to devise sophisticated strategies for avoiding the impact of stated laws. It is — to some extent, at least — possible, and it is the professional's duty, within the framework of the law, to do the best he can for his client. After all, the creditor-claimant's advisers will be doing the best they can for theirs!