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**Improving Your Form:  
Serious Oversights in Asset Protection Trusts  
And How to Avoid Them**

**By Alexander A. Bove, Jr.**

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Few would question the surge in popularity of the offshore trust over the past decade, “offshore” in this sense meaning a trust settled in a jurisdiction other than that of the settlor. Offshore trusts may be established for a number of reasons, but by far the most common is to protect the assets of the settlor, simultaneously allowing the settlor to enjoy the benefits of such assets. While lawyers worldwide have been glad to accommodate such peripatetic settlors, they have, perhaps unknowingly, been doing so almost universally with faulty documents.

As a general rule, lawyers love forms, especially someone else’s forms. They save time, trouble, hours of research, and they make money. When we are given the opportunity to use “recommended” forms from another law firm or from a corporate trustee, we tend to accept them (and use them) at face value, and this has unquestionably been the case with offshore asset protection trusts. Unfortunately, some of the most important provisions in the commonly used forms for such trusts simply don’t work or won’t accomplish the intended result. This discussion

will identify what the author believes are the most important of those provisions and offer some practical solutions.

### **Protector Provisions**

An asset protection trust without a protector is like a ball game without a referee. Who would question the value of having a protector in a trust? Here we have an “outside” party who may be empowered to do anything from vetoing trust distributions to adding or deleting beneficiaries to amending or terminating the trust, all without the need for court intervention. Where we have irrevocable trusts holding large chunks of a client’s assets managed by strangers in a jurisdiction thousands of miles away, the presence of a protector, viewed as a supervisor or overseer, can provide a significant degree of comfort to the settlor.

But despite the importance of the position, we seem to be inclined to blindly follow the conclusions and suggested provisions of someone else’s forms. For instance, until recently, many advisors and even a few commentators maintained that the protector is not a fiduciary, and in any event, they maintain that if there was a question about it, the protector’s fiduciary responsibility could simply be drafted away and virtually all the commonly used forms reflect this position. A knowledgeable practitioner who carefully considers the duties and role of an independent protector has to conclude just the opposite and should draft accordingly to avoid needless questions, delays, and legal expense. (See *Steele v. Paz, Ltd*, Manx LR 102 426 (High Court, Isle of Man 1993-95.) Of course, it is possible to give the protector personal powers, but then the role is not really one of trust protector, rather, it is to protect the protector’s own interests. (See, e.g., *Rawson Trust v. Perlman*, Bahamas Supreme Court 25 April 1990).

Where the trust itself raises the question as to whether the protector is a fiduciary, the questions that necessarily follow often center around administrative issues, including whether the protector has the right to compensation, to reimbursement, to hire agents, etc. In the typical case, where the role of the protector is to protect the integrity and purposes of the trust, it is irresponsible, if not negligent to leave such questions unanswered. Thus, the well-drafted and well thought-out protector provisions will address these questions in clear terms.

Perhaps one of the riskiest and most vulnerable situations occurs when the protector is given broad powers and is a “local” person (or organization) subject to jurisdiction of courts in the settlor’s jurisdiction. For asset protection purposes, this could be disastrous, since a local court could treat the protector as the debtor/settlor’s agent and order the protector to act, subjecting the protector to contempt proceedings if he refuses to comply with the order. Some advisors argue that under the usual anti-duress provision the offshore trustee would simply refuse to follow the protector’s direction pursuant to the court order, and while this may be so, it would at the same time render totally useless the very purpose of having the protector in the first place. This could be a serious loss, for example, in cases where the protector has the power to change the trust situs or to delete beneficiaries, powers that trustees are reluctant to exercise without court approval. Other advisors deal with this exposure by restricting the local protector’s powers to negative powers (e.g., the power to veto proposed trust distributions), but once again, this basically emasculates the protector and misses the opportunity to build flexibility into the trust through the protector. All of this points strongly to the conclusion that the protector should not be a local person, and the trust provisions should limit the eligible appointees accordingly.

### **Solutions**

Where a protector is included in the trust, do not waste time and expense by declaring that the protector is not a fiduciary, unless he truly is not, which would only occur where the protector’s powers are personal, or where the power is a non-fiduciary power of appointment. Otherwise, be sure to address the issues of compensation, etc., as noted above.

For those drafters who, for some reason, do not wish to have a protector, local or otherwise, at the time the trust is drafted, it makes good planning sense to allow for the possibility that one may be needed or desired in the future. Rather than amending the trust to accomplish this, the author recommends a provision allowing for a “springing” protector, one who is not a local person or entity. Such a provision would give the trustee (or some other person) the power to appoint a protector for the trust where none existed previously, thus creating the position. The provision could allow for the appointment of a protector for a specified period of time or

permanently, or give the trustee the power to revoke the appointment or suspend the position indefinitely. Such a provision should include all the necessary clauses for protector powers, compensation, removal and/or replacement, etc. Attention to all of these issues will enhance the flexibility, integrity, and asset protection qualities of the offshore trust.

### **Flee (Re-Settlement) Clause**

The “flee” or “flight” clause is another provision one finds in virtually every asset protection trust and is one of those provisions that impresses just about everyone when they first hear about it. The basic concept suggests that if and when a creditor gets serious and attacks or threatens to attack the offshore trust at its home base, the flee clause can be neatly and quickly exercised (before the creditor’s suit hits the fan), and the whole banana “immediately” moves to a different foreign jurisdiction, thus frustrating the creditor’s attack. This has to be one of the biggest myths in the offshore trust world. The fact of the matter is that the typical flee clause is cumbersome and extremely time consuming to effectuate. It should be called the molasses clause. By the time the flee clause gets even close to fruition, the creditor has likely obtained a “Mareva” injunction in the original jurisdiction, freezing the trust’s assets and rendering the flee clause a flop. See *Mareva Compania Naviera SA v. International Bulkcarriers SA*, (1975) 2 Lloyd’s Rep 509. And see *515 S. Orange Grove Owners Ass’n v. Orange Grove Partners*, Plaintiff No. 208/94 (High Ct. Rarotonga, Civil Div., Nov. 6, 1995); *FTC vs. Affordable Media, LLC*, 179 F.3d 1228 (9th cir. 1999), and *Grupo Torras S.A. et al v. Sheikh Fahad Mohammad AL Sabah*, Supreme Court of the Bahamas C.L. 72 of 1994).

To illustrate, let’s take a quick walk through the operation of a flee clause to see why what we see is not what we get. First, before the clause can be implemented, a new jurisdiction with appropriate protective laws must be selected, along with a trustee in that jurisdiction. Note that in virtually all asset protection jurisdictions a corporate trustee, meeting all local registration requirements, will be required. Next, the proposed new trustee, before accepting the trust, will want to review the trust and all previous trust accountings. It will want to see the assents to the accounts as well as the existing trustee’s due diligence reports. In addition, the new trustee will want to conduct its own due diligence to satisfy all legal and fiduciary duties, as well as

clearance of all money laundering issues. And then, because of the oncoming litigation (which must be disclosed to the new trustee), the new trustee may or may not accept the trust.

On the “other side” of the transfer, the existing trustee will want releases from all ascertainable beneficiaries or their representatives (and in some cases the unascertainable beneficiaries must be represented) and the trustee will undoubtedly want an indemnification agreement from the key parties, as well as the new trustee, in case the existing (existing) trustee incurs expenses or legal fees in defending an action against it relating to the trust or to the exercise of the flee clause. There is also the possibility that the trustee might request court approval of the change, causing additional fees and delays.

After these numerous and time-consuming tasks are accomplished, the transfer of assets from the existing trustee to the new trustee must then be carried out. Presumably, the trustee of the existing trust holds securities, and if they are to be transferred in kind, even more time is required. Although it would be faster if the securities could be liquidated and the proceeds transferred, the existing trustee may be very reluctant to do so without further indemnification if the liquidation would result either in taxable gains or losses. It may take just as long to draft and approve the necessary additional indemnification agreement between the parties as it would to transfer the securities.

In short, the creditor could just about row to the offshore jurisdiction then walk to the court to ask for his Mareva injunction before the flee clause did its intended job. So, is there something else that would work better?

### **Solution**

The author proposes what he calls a “Resettlement” clause to replace the flee clause. Typically the flee cause is implemented by the trustee, whose fiduciary duties and exposure to liability severely limit quick movement, as illustrated above. Instead, we can give a third party, which could include the protector, the independent power to appoint any part or all of the trust property to another trust, in one or more other jurisdictions, with substantially the same provisions as the

existing trust. Remember, with a flee clause, we must continue to deal with the existing trust until every last element of the move is completed, and until that occurs, we will be subject to the courts of the jurisdiction from which we are trying to flee. The exercise of a power, on the other hand, when compared to the flee clause, can be virtually instantaneous. This is not to say it would happen overnight, but more like a week or so, instead of three months or much more, as with the flee clause.

Furthermore, with the exercise of a power neither the existing nor the new trustee would have to be involved in extensive agreements, obtain releases, etc., etc. They would merely have to satisfy themselves that the power was exercised in accordance with its terms. It would also be extremely important to include language that indemnifies and holds harmless both the old and the new trustees on implementation and acceptance of the exercise.\*

### **Co-Trustee Escape Clause**

Some advisors feel that the problem with the slow flee clause can be circumvented by having a co-trustee in another jurisdiction from the outset of the trust, giving the co-trustee the power to act alone, or to have a controlling vote when it saw fit to exercise control. According to this theory, when a creditor threatens an attack, the co-trustee would simply act on its own to transfer the trust assets to its (new) jurisdiction and out of the hands of the targeted trustee. Since the targeted trustee would not be the one making the transfer, it is thought there should be no obstacle in doing so, and since the trust gives the co-trustee the power to act alone, the targeted trustee should have no liability on its part. Further, it is likely (and perhaps necessary) that the trust would contain language exculpating the targeted trustee for complying with the transfer to the extent necessary.

There are many potential problems with this arrangement. Whether the targeted trustee, as a matter of practice, would stand by and allow the transfer to take place may depend upon the circumstances. If the creditor has managed to obtain a Mareva injunction (freezing the trust assets), it is unclear whether the targeted trustee then may be exposed to liability if it does

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\* The author will be pleased to offer sample language on request.

nothing to prevent the transfer by the co-trustee, and it is also unclear (if not highly unlikely) that the co-trustee would even attempt to make the transfer in violation of the court's order. Further, it is even more unlikely that the targeted trustee would agree to be left with no funds to continue its own defense. And if they did work together to move the funds in anticipation of an imminent order, would this arrangement suggest some complicity between the two trustees to circumvent the court order? It would seem that similar questions would apply where the co-trustee was given the power to remove the targeted trustee, and did so, frustrating the court order.

While it is possible that the co-trustee arrangement could work, it is not without some additional complications, and, like the typical flee clause, it seems to look a lot better on paper than in practice. For instance, since the co-trustee must be appointed at the outset or at least long before any creditor issues arise, the trust document must be reviewed and approved by both trustees in both jurisdictions, adding some expense. Next, it would seem appropriate for the co-trustee to charge some annual fee, even though perhaps not a full one, just for holding the position and standing by, an additional annual expense, even though the co-trustee may never take over. Then, it is unclear whether the co-trustee has the responsibility to monitor the other trustee on a regular basis, or review accounts, or whether the targeted trustee has a duty to periodically report or account to the co-trustee. In many asset protection jurisdictions, the local trustee must register the trust in order to gain protection. In the case in question, would the inactive co-trustee have to register a trust from another jurisdiction? And if it did not register the trust, what would we have? If the co-trustee gets no reports or accounts, never monitors the other trustee or the activities of the trust, does not register the trust locally, and does literally nothing until some unpredictable time when some alarm goes off and the trustee is called upon to come to life, couldn't it be argued that as to that trustee, there is no trust? Nevertheless, as noted, the co-trustee escape maneuver is considered by some to be a workable alternative to the standard flee clause, although for the numerous reasons stated herein, it is never used by the author's firm.

## **The “Jones” Cause**

What the devil, you might ask, is a “Jones” clause? Good question. Although the author could find no one who knew where the name comes from nor any meaningful resource on the subject, in the vernacular of the offshore asset protection clan, a Jones clause, sometimes also called a “contingent payment” clause, is a provision in an asset protection trust that allows the trustee to pay certain claims against the settlor, despite the protective nature of the trust. While this might at first glance appear to be an oxymoron, in some cases the offshore trustee may require it, while in other cases advisors themselves insist on it in the hopes that it would avoid exposure to penalties, disciplinary action, or court sanctions for fraudulent transfers.

It is not unusual that a client rushes in to his advisor to arrange to protect his assets just after an incident has occurred or even after a formal claim has been made. The prudent and experienced advisor will discover this in the due diligence process and report it to the offshore trustee in response to the trustee’s due diligence process. In most cases, the advisor and/or the trustee will want evidence that the settlor has retained adequate funds to cover the outstanding claim or will require the client to consider including in the trust a provision to the effect that if the claim results in a judgment (and all appeals or opportunities therefor have been exhausted), then the trustee may pay the claim from the trust assets – i.e., a Jones clause.

As noted earlier, there are no resources or studies on “Jones” clauses nor any reported cases the author has been able to find. Despite this, there are a variety of very different “model” provisions used and shared by various firms, and a careful examination of these provisions reveals serious oversights. The intention of the typical contingent payment (Jones) clause is to permit payment from the trust for money judgments obtained by specified creditors or creditors of specified claims in existence at the time of the trust settlement, provided the judgment is final and no further appeals are available. But that does not mean that the judgment creditor merely phones it in to the offshore trustee and gets a check in the mail. Presumably, the creditor would be required to appear in the foreign jurisdiction (of the trust) with certifiable and admissible evidence of his judgment, as well as clear evidence that the judgment is the result of the same

claim contemplated in the contingent payment clause contained in the trust. Then he would be paid, I think.

Unfortunately, many, if not most drafters seem to overlook entirely the fact that unless the clause is drafted so that the trustee of the offshore trust has no discretion as to payment but rather is compelled to pay under the terms of the applicable clause, the clause would be useless. This is because statutes in virtually all of the offshore jurisdictions in effect provide that payments may not be made to a creditor of the settlor (they are typically “excluded beneficiaries”), and then there is the conflict that the creditor’s claim is being made outside the limitations period for such claims. Further, most such jurisdictions do not recognize foreign judgments. In addition, many offshore trusts by their terms expressly prohibit payments to creditors of the settlor, which would directly conflict with the contingent payment clause. Accordingly, from a practical if not a legal standpoint a trustee could virtually never make a payment under a contingent payment clause unless it was absolutely mandatory, and acknowledged (and superseded) any conflicts, and the trustee is absolutely exculpated for making any such payment.

### **Solution**

In drafting contingent payment clauses, avoid needlessly complex and irrelevant details which only serve to confuse the implementation of the clause, thus making it necessary for the trustee to exercise discretion in interpreting the clause, in turn placing the trustee in a position where it is likely to refuse payment for fear of exposure to the other beneficiaries for making a payment to a creditor whose claim might otherwise have been unenforceable against the trust. The clause should be clear and precise, identify the specific claim, if appropriate, provide for mandatory payment on satisfaction of the stated requirements, exculpate the trustee, and say absolutely no more than it has to. And even then, we are not really sure of the outcome as there appear to be no precedents on which we can rely.

## **Conclusion**

With the increasing popularity of offshore asset protection trusts and the accompanying rush in a number of jurisdictions to pass accommodating laws, many if not most advisors have been perhaps involuntarily led to adopt forms of trusts and trust provisions that are unlikely to work as intended. A careful analysis of the problematic provisions in light of the objectives, however, shows that the reasonable changes suggested in this discussion can produce the desired results.

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