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Trusts and Estates Forum

A Connecticut Judge Tackles The "Now You See It – Now You Don't" Dilemma of Offshore Trusts

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One of the most basic principles of asset protection planning is to avoid having the client's assets be an "easy take" for his creditors, the worst case being where the client has everything in his own name. From there we move up the asset protection step-ladder to joint ownership, tenancy by the entirety, trusts, corporations, limited partnerships, annuities and insurance (in some states), limited liability companies, and at the top of the ladder, funded offshore trusts. Offshore trusts (established in the "usual" offshore jurisdictions) are at the top generally because it is so difficult, in some cases legally impossible, for a creditor of the settlor to reach the assets in the trust. This, in turn, is because the commonly used offshore jurisdictions do not recognize U.S. judgments or court orders, the open period of limitations for fraudulent transfers is very short, and the properly selected offshore trustee does not have any U.S. presence to allow for service of process. Thus, a creditor's attempt to reach the trust assets to collect on a judgment is utterly frustrated. A recent Connecticut case, however, has attempted to overcome this dilemma, at least with respect to certain assets. *Nastro v. D'Onofrio,* 263 F. Supp. 2d. 446 (D. Conn. 2003).

Vincent Nastro and Arthur D'Onofrio were co-owners of the shares of U.S. Propeller Service of California, Inc. When Nastro discovered that D'Onofrio was misappropriating corporate funds, he sued in California and obtained a judgment against D'Onofrio for over a half million dollars in compensatory damages. Fourteen days after the judgment, D'Onofrio, who also owned several companies in Connecticut, transferred his entire interest in the Connecticut companies with a reported value of $650,000 to the trustee of a trust established in Jersey, part of the Channel Islands. Nastro followed by bringing suit in the U.S. District Court for Connecticut seeking to enforce the California judgment and requesting a preliminary injunction on transfers of the Connecticut companies, as well as an avoidance of the transfers to the offshore trust as being fraudulent. It is interesting to note that the law firm which assisted D'Onofrio in establishing the trust (and the individual attorney involved) were also named as defendants, for participating in the alleged fraudulent transfer and for violating the Connecticut Unfair Trade Practices Act.

In his opposition to the issuance of the injunction, D'Onofrio argued that the court did not have personal jurisdiction over the trustee, who was an "indispensable party" and a "necessary party" in the matter, and, therefor, without jurisdiction over such parties, the case should be dismissed. As to the fraudulent transfer, D'Onofrio argued that under Connecticut law reflecting the Uniform Commercial Code, if the stock certificates in question are "certificated" (actually issued to the registered owner), they may only be reached by actual seizure of the certificates themselves. Since the certificates were apparently issued and in the hands of the offshore trustee, and since the situs of a certificated security is deemed to be the place where the certificates are physically located, this was not about to happen. Accordingly, it would be impossible, D'Onofrio argued, for the court to grant Nastro the requested relief.

Addressing these arguments, the court first addressed the question of whether the trustee is a "necessary party". It was observed that in an action to set aside a transfer as fraudulent, the transferee is a "necessary party" since it has an interest in the property transferred and must be given the right to be heard. Thus the Court agreed that the trustee was in fact a necessary party. Next, the court considered whether the trustee is subject to the personal jurisdiction of the court. Although Nastro somehow managed to serve the trustee with notice of the proceeding, the trustee did not respond, and therefore the question of whether the Connecticut court had jurisdiction over the offshore trustee remained. In addressing this question, the court considered whether the trustee may be subject to jurisdiction based on Connecticut's "long arm" statute. It was found, however, that the trustee did not have sufficient, if any, activity in Connecticut, and that "the unilateral activity of those who claim some relationship with a non-resident defendant cannot satisfy the requirement of contact with the forum state." Thus, the court held, it would be unconstitutional to exercise personal jurisdiction over the offshore trustee, citing *Hanson v. Denkla*, a 1958 U.S. Supreme Court case holding (briefly) that a Delaware trustee which was not subject to a Florida court's jurisdiction was not bound by the Florida judgment, and that the Florida court's exercise of jurisdiction over the Delaware trusts (based on a Florida domiciliary's exercise of a power of appointment over the Delaware Trusts) violated due process. (357 U.S. 235).

Next came the question as to whether the trustee was an "indispensable" party to the action. This issue was "disposed" with quickly by the court based on a Connecticut procedural rule allowing the court, in such cases, to "determine whether in equity and good conscience the action should proceed among the parties before it." D'Onofrio's position was that the trustee was an indispensable party because it held the actual certificates and they could not be seized without jurisdiction over the trustee. Therefore, arguing again that since it would be legally impossible for the court to grant Nastro's requests, D'Onofrio's position was that the matter should be dismissed. And this is where the case broke new ground for asset protection planning purposes.

Although Connecticut's Uniform Commercial Code (UCC) law provides that in order to levy on stock certificates which are certificated they must be physically seized, the court observed that the UCC is not preemptive over the fraudulent transfer law, and the UCC "does not hamper the court's ability to issue (sic) new certificates as equitable relief from the perpetration of a fraud. Because the certificates evidence ownership of Connecticut corporations which have been named defendants to this action, the court could <u>order the corporations to delete the trustee as owner of</u>

the stock in the corporate ledger and issue new certificates in favor of D'Onofrio." Presumably, D'Onofrio would then be ordered to endorse them over to Nastro to satisfy the judgment (although one wonders why the court would not order the certificates to be issued directly to Nastro, the creditor). In view of these conclusions, the court observed that it was not at all impossible to grant Nastro's request.

As an aside, there is one particularly curious, if not troubling, aspect of these facts. When a person establishes an offshore trust it is a matter of fairly strict procedure that the settlor complete, file, and sign a statement with the offshore trustee attesting to his assets and liabilities, and stating in particular whether there are any lawsuits or claims against him threatened, pending, or expected. Of course, an outstanding judgment against the person would be highlighted in this report. When the offshore trustee finds that the proposed transfers to the trust would clearly render the settlor insolvent, as in this case, the trustee would decline to accept the trust and the assets. An exception to this may occur if the trust contains a "Jones Clause" (see Alexander A. Bove, Jr., *Drafting Offshore Trusts: Are we evolving, or perpetuating predecessors' misconceptions?* Trusts & Estates July 2004) which, briefly, acknowledges a particular claim against the settlor and allows the trustee to pay it on verification of final judgment. It is unknown whether D'Onofrio's trust contained such a clause.

Another relevant issue, especially to attorneys practicing in this area, is whether D'Onofrio's attorneys could be held liable for money damages for participating in what was clearly a fraudulent transfer of the stock to the offshore trust. Here, the court pointed out that Connecticut law is clear on this point, that there is no authority supporting a claim against an attorney for aiding and abetting in a fraudulent transfer. Further, the court noted that "the Connecticut Supreme Court has held that an attorney may not be liable under [the Connecticut Unfair Trade Practices Act] even for intentional conduct, provided that the attorney was representing his client." Although other states (e.g. Florida) have held similarly, at least one, New Jersey, recognizes a claim for attorney liability in such cases. *Banco Popular v. Gandhi*, 823 A.2d 809 (N.J. App. Ct. 2003). Further, legal commentators have differing opinions on the issue and most asset protection attorneys will avoid assisting clients in making transfers to offshore trusts in the face of a lawsuit, let alone an outstanding judgment against the settlor.

In any event, in this particular case many feel that the most disturbing aspect with respect to offshore planning is the court's statement that it could exercise jurisdiction over the subject corporations, ordering certificates held by the offshore trustee cancelled ("deleted") and new certificates issued to give effect to the satisfaction of a judgment. This holding seems to be in direct contradiction to the court's simultaneous holding that the trustee was a necessary party to the action and had the right to defend against the taking of its property. And the authority for this position is based on the very issue present here – that of rescinding a fraudulent transfer. To leap over this obstacle appears to be a substantial flaw in the court's decision, although perhaps the reasoning was that since the trustee had notice of the action (it was served by Nastro, according to the case report) and did not elect to appear, the court was free to decide the case. It is simply unclear and could well be the basis for an appeal of the ruling.

If the ruling should hold up, another critical question is just how far this end-run method of recovery will reach. Here the corporations were closely held; just one shareholder. Could the same holding apply to shares of General Motors or any other publicly traded company? If so, wouldn't this materially interfere with everyday market transactions? We believe it would, and we believe that a transfer agent for a publicly traded company would only comply with such an order if a bond were posted protecting the company and agent for the <u>full value</u> of the transaction. Otherwise, the "deleted" shares could, for example, be sold in some other part of the world to a bona fide purchaser for value, and the transfer agent would be required to honor the sale, despite the fact that replacement securities had been issued. Thus, like the reports of Mark Twain's death, perhaps the concern over the decision is exaggerated. On the other hand, in terms of protecting investments held in an offshore trust, it is important to observe that in many of today's trust portfolios the investments are *not* "certificated;" instead they are usually held in "street" name (the name of the broker with which the account is held), and if it is a U.S. broker or U.S. branch of an offshore broker, perhaps they could be frozen under the concept of the *Nastro* case. Similarly, even where the investments are certificated, they are often held by a U.S. investment manager or custodied with a U.S. bank or broker, and in those cases, they could clearly be reached by a U.S. court. Other than *Nastro*, however, there appears to be no precedent for such action. So, rather than wait for more such action from courts which decide to follow

Nastro, and to obtain greater protection of such assets, the offshore trust could hold only offshore bank accounts and securities of non-U.S. companies which would - we think – be beyond the reach of U.S. Courts.