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Trusts and Estates Forum

**THE FLEE CLAUSE:
A SIREN SONG OF ASSET PROTECTION TRUSTS**

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Asset protection trusts are, obviously, designed to protect one's assets. As such they are adorned with every protective feature the creative legal mind can imagine, including, for example, change of law provisions, protectors (who can be given the power to virtually re-draft the trust to suit any occasion), and, of course, the so-called "flee clause," which we propose, after much experience, turns out to be about as helpful as a broken leg.

In concept, when a creditor of the settlor undertakes an attack on the asset protection trust in an effort to reach the settlor's funds, the flee clause is triggered and the trustee causes the trust, together with all of the trust assets, to move (i.e., flee the jurisdiction) out of the creditor's reach before the creditor fires his first shot within that jurisdiction at the trust assets. But, the flee clause in practice appears to the authors as total waste of time and money, destined to almost never work in the face of an attack. Why? The actual steps that must be taken to implement a legal migration of the trust from one jurisdiction to another are so time-consuming and vulnerable that such a clause offers the settlor virtually no protection at all.

To illustrate, let's examine the required steps, all along keeping in mind the inevitable permutations and dilatory details that creep into every transaction (e.g., "he's in a meeting and can't get back to you until tomorrow;" "your fax didn't come through, please re-send it;" "we will send the originals by courier – that only takes 3 to 5 days;" and, "we have to run that by our legal department; we'll get back to you.")

The first question to decide, of course, is, exactly when does the trust flee? On the threat of a lawsuit? When a lawsuit is filed in another jurisdiction? After a judgment? Most corporate trustees would be reluctant to take such a drastic step on a threat, or maybe even on the initiation of a suit in a foreign (to the trust) jurisdiction. The next question is, just where does the trust flee to? If the trust is in the Cook Islands, should the Cook Islands trustee look to Gibraltar? Mauritius? Liechtenstein? What are the criteria for selection, who decides, and who, if anyone besides the trustee, needs to approve the decision? It seems reasonable to assume that a corporate trustee would at least want the beneficiaries' assent to the selection.

Next, there is the need to engage a trustee in the new jurisdiction, and of course, before accepting the trust, the new trustee will want to review the trust and all previous trust accountings. In addition, the new trustee will want to see the assents to the accounts, as well as the existing trustee's due diligence reports. Further, the new trustee will undoubtedly want to conduct its own due diligence to satisfy all legal and fiduciary duties, as well as, importantly, clearance of all money laundering issues. The new trustee may also require indemnification from the current trustee. And then, because of the anticipated claim or litigation (which must be disclosed in detail to the new trustee), the new trustee may or may not accept the trust. How much time will all this take?

Then there is 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 its own indemnification agreement from the key parties, if not an actual set aside of funds, in case the existing (exiting) 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 either trustee might request court approval of the change, causing additional fees and delays. After these numerous and time-consuming tasks and documents are accomplished, the actual transfer of the trust assets from the existing trustee to the new trustee must then be carried out.

Since in virtually all cases the activation of the flee clause will result in a change of legal jurisdictions, a transfer of the actual securities held in the trust is likely to be somewhat time consuming, even if all goes well. Typically, a physical transfer of securities from one trustee to a trustee in another jurisdiction can take several weeks, at best. And keep in mind if the securities are of US companies held in the name of a foreign trustee, transfer to a different foreign trustee in a different foreign jurisdiction through US transfer agents could prove a formidable task. The bad news is that until the actual transfer is completed, title remains in the exiting trustee, meaning the assets may be reachable during all that time. A much quicker method would be for the trustee to liquidate all trust assets on a cash basis and wire the funds to the new trustee. Of course, this method will produce either capital gains or losses, so at the very least the trustee would require written approval by the beneficiaries prior to a sale, if not court permission. (More documentation!)

Is all of this hypothetical and even exaggerated? Unfortunately, it is not. The authors have had experience in similar transactions, and although (fortunately) no court proceedings were involved (there was just a desire to change trustees), in addition to the incredible frustration in passing drafts upon drafts of documents back and forth among the trustees and their counsel, all running up substantial costs to the trust (and thus the beneficiaries), one such matter took nearly three months to complete. When you consider that a creditor can obtain a “Mareva” injunction in the offshore jurisdiction (to freeze the trust assets) typically in a matter of several days, the flee clause turns out to be a bad joke.

Is there a viable alternative? We believe there is. In place of the flee clause, we propose what we call a “resettlement clause.” Typically, the flee clause is implemented by the trustee, whose fiduciary duties and exposure to liability severely limit quick movement, as illustrated above. Instead, the trust can give a third party, which would normally be the trust 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, you must continue to deal with the existing trust until every last element of the move is completed, and until that occurs, the trust and its assets will be subject to the courts of the jurisdiction from which the trust is 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 two, instead of three months or much more, as with the flee clause.

Another reason the resettlement clause will operate more efficiently than the flee clause is that the exercise of the power effectively takes the authority out of the trustee's hands, and places it in the hands of the protector. It is not a discretionary decision on the part of the trustee, as is the usual flee clause. And since according to the terms of the resettlement clause the trustee is held harmless for following the protector's exercise of the power, there would be no need to get court permission, beneficiaries' assent, etc. There does remain, however, some exposure to the delays in transferring title to assets. This issue is present regardless of the method of changing trustees or jurisdictions. For this reason, the suggested resettlement clause should also give the protector the power to order the trustee to liquidate the trust portfolio and immediately transfer the proceeds to the new trust established by the protector in the new jurisdiction pursuant to the resettlement clause. Such a provision would not only exculpate the trustee from liability for any adverse tax resulting from the liquidation but would exculpate the protector as well. If the potential tax costs seem to be a drawback, remember that the flee clause or its equivalent is an emergency measure designed to protect the trust assets from attack. If the cost of such protection is a capital gains tax, that has to be preferable to a loss or at least a freeze of the entire portfolio. As for a full liquidation of the portfolio in order to make the transfer occur within a matter of days, this would be highly unlikely to happen if the trustee were acting on its own. We would be back to that slow climb up the fiduciary ladder of documents, accounts, and assents. Lastly, the protector would likely leave some funds with the existing trustee to cover expenses if a creditor does come along after the move.

In short, with the exercise of a power by a third party, neither the existing nor the new trustee would have to be involved in extensive agreements, releases, etc., because, as noted above, control would be out of their hands, and they would be expressly exculpated for complying with the terms of the exercise. The existing and new trustee would each merely have to satisfy themselves that the power was exercised in accordance with its terms. And as suggested, it is extremely important that the resettlement clause include language that indemnifies and holds harmless both the old and the new trustees on implementation and acceptance of the exercise. The other documents that typically accompany the offshore trust arrangement (e.g., management agreement, due diligence documentation) generally would not hold up the transfer of funds, as the funds could be held in custody in the new jurisdiction subject to the completion and acceptance of such documents.

Even though asset protection trusts have been utilized for many years now, there has been surprisingly little testing of their “special” provisions, obviously including the flee clause, which, when carefully analyzed, may prove useless when implementation is attempted. Accordingly, we have a professional duty to carefully analyze the provisions we use no matter how attractive they may sound, rather than assume they will work just because some other professionals use them.

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