[Vanderbilt Journal of Transnational Law](https://scholarship.law.vanderbilt.edu/vjtl)

Volume 32
Issue 3 *May 1999*

Article 8

5-1999

Offshore and "Other" Shore Asset Protection Trusts

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Think of the liability system as a poker game. Each person, corporation, or other entity in the economy is a player. Players risk their chips, that is, their wealth, by tossing them into the pot, that is, investing them in liability-generating economic activity. Chips contributed to the pot are at risk of loss; the system can take them to satisfy liability. Chips withheld are not at risk.

This poker game has an odd twist to it. Withholding chips does not reduce significantly the amounts players can win nor players' likelihood of winning. Even players who don't put any chips in the pot—that is, players who are judgment proof—can keep playing the game and are eligible to win.

Why do players put chips in the pot? No rule requires them to do so. There are social, cultural, and economic pressures. But mostly, they do so for convenience. A wealthy player who wants that wealth available for use, but not in the pot to be lost through liability, must build arcane legal structures and document them through extensive record keeping.

In recent years, computer technology has dramatically reduced the cost of record generation and, consequently, the cost of keeping chips out of the pot. Major players are reducing their stakes. By doing so, they are breaking down the social norms and cultural barriers that prevent further reductions. The process is feeding on itself. Soon no one will have significant chips in the pot. When that happens the fundamental nature of the game will change. Liability will die.[1]

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1. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 3 (1996).

I. INTRODUCTION

The use of offshore asset protection trusts to "keep chips out of the pot" has exploded in the last decade. In 1994, one commentator estimated that approximately $1 trillion was held in offshore trusts.[2] Less than five years later, Britain's Home Secretary Jack Straw estimated in a recent unpublished report that $6 trillion is now held in offshore trusts.[3] The Home Secretary report estimated that this is as much as a third of the wealth of the world's most affluent people.[4] An estimated five to ten percent of the $6 trillion, up to $600 billion, is held in the tiny British offshore islands of the Isle of Man, Jersey, Guernsey and Sark.[5] There are an estimated 100,000 offshore trust companies in the British offshore islands.[6]

The use of offshore asset protection trusts is no longer limited to the ultra-rich. Offshore trusts are marketed in financial magazines and on the internet to people whose net worth is in the hundreds of thousands of dollars. Setting up an offshore trust is not cheap. Attorneys specializing in offshore trusts typically charge as much as $18,500 to set up a trust and several thousand dollars each year for maintenance of the trust.[7] However, if a person owns several million, or even several hundred thousand, dollars of assets and has trouble with creditors on the horizon, this may be a relatively small price to pay to put assets out of the reach of creditors.

Recently, Alaska and Delaware have enacted trust laws that purport to provide some of the same type of protections against the claims of creditors that are found in the laws of offshore jurisdictions.[8] These domestic asset protection trusts may have several advantages over offshore trusts. First of all, they are cheaper: it may cost only $6,000 to $12,000 to set up an Alaska

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2. *See* William J. Zink, *Assets of Foreign Grantor Trust Not Includible in Grantor's U.S. Gross Estate*, TAX ADVISOR, Feb. 1994, at 84.
3. *See* David Leigh, *Billions Hidden Offshore; Jersey Faces Tax Clampdown*, GUARDIAN (London), Sept. 26, 1998, at 1, *available in* LEXIS, NEWS Library, CURNWS File.
4. *See id.*
5. *See id.*
6. *See id.*
7. *See* Debra Baker, *Island Castaway*, A.B.A. J., Oct. 1998, at 55, 59.
8. *See* ALASKA STAT. § 34.40.110 (Lexis 1998); DEL. CODE ANN. tit. 12, §§ 3570-76 (Supp. 1998).

trust.[9] In addition, settlors may feel that their assets are safer in a U.S. trust than they would be in a foreign trust.[10]

Asset protection trusts and asset protection trust laws are designed to protect a person's assets from the claims of his creditors. It is virtually impossible to obtain personal jurisdiction over an offshore trustee. Further, the typical offshore jurisdiction does not recognize foreign judgments.[11] Thus, a fraudulent conveyance action in a United States court against an offshore trustee offers little or no hope for recovery.

Offshore jurisdictions have either short statutes of limitation on fraudulent conveyance actions or, as in the case of Belize, no fraudulent conveyance statute at all. The Cook Islands trust law provides that a fraudulent conveyance action must be brought within two years of the time a claim accrues and within one year of the time assets are transferred to a trust.[12] The practical effect of these short limitation periods is that by the time a creditor finds out where the money is and files an action, the statute of limitations has run, thereby barring a suit. Even where a fraudulent conveyance action is available, the plaintiff-creditor carries a heavy burden of proof. For example, the Cook Islands law requires a creditor to prove beyond a reasonable doubt that the settlor of a trust had an actual intent to defraud the creditor bringing the action and that the transfer rendered the settlor insolvent.[13] Under the Cayman Islands law, a creditor must prove that the settlor transferred property with fraudulent intent and for inadequate consideration.[14]

The laws of asset protection jurisdictions provide that self-settled trusts are valid, i.e., that assets in these trusts are not subject to the claims of creditors because the trust was self-settled. For example, section 12(4) of the Belize Trust Act of 1992 provides that "[a]ny rule of law or public policy which prevents a settlor from establishing a protective or a spendthrift trust of

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9. *See* Brad Burg, *Is This The Best Asset-Protection Method Ever?* MED. ECON., Feb. 23, 1998, at 106, *available in* LEXIS, NEWS Library, CURNWS File.

10. *See* Lynn M. LoPucki, *Virtual Judgment Proofing: A Rejoinder*, 107 YALE L.J. 1413, 1415 (1998) ("Americans can now judgment-proof themselves without transferring their money and the titles to their properties to strangers offshore.").

11. *See* International Trust Act, § 13D (1996) (Cook Is.) *reprinted in* 1 INTERNATIONAL TRUST LAWS AND ANALYSIS at CKI 122-23 (Walter H. Diamond & Dorothy B. Diamond eds. 1999).

12. *See id.* § 13B(3), *reprinted in* 1 INTERNATIONAL TRUST LAWS AND ANALYSIS, *supra* note 11, at CKI 120-21.

13. *See id.* § 13B(1), *reprinted in* 1 INTERNATIONAL TRUST LAWS AND ANALYSIS, *supra* note 11, at CKI 120.

14. *See* Fraudulent Dispositions Law § 4(1) (1989) (Cayman Is.), *reprinted in* 1 INTERNATIONAL TRUST LAWS AND ANALYSIS, *supra* note 11, at CAY 137.

which he is a beneficiary is hereby abolished."[15] In 1997, section 34.40.110 of the Alaska statutes was amended to allow settlors to create spendthrift trusts.[16]

Typically, asset protection trust laws provide that the settlor may specify that the courts of the asset protection jurisdiction have exclusive jurisdiction over the trust property and that the laws of the asset protection jurisdiction are applicable to interpret and determine the validity of the trust. For example, section 13.36.035 of the Alaska statutes provides that a settlor may choose Alaska law;[17] that the settlor's choice of Alaska law will be valid as long as, *inter alia*, (a) some or all of the trust assets are deposited in Alaska and are being administered by a "qualified person" (i.e., an Alaska resident, an Alaska trust company, an Alaska state bank, or a national bank with its principal place of business in Alaska), (b) the trustee is a qualified person who is designated as a trustee under the governing instrument or by a court having jurisdiction over the trust, and (c) part or all of the trust administration occurs in Alaska, including physically maintaining trust records in Alaska;[18] that Alaska courts have exclusive jurisdiction over trusts that contain a valid Alaska choice of law clause;[19] and that Alaska law be applied to determine the validity, construction and administration of Alaska trusts.[20]

Obviously, asset protection trusts create problems for individual creditors. The August 3, 1998, issue of *Business Week* includes an article about Donald and Joanna Hess.[21] Two months before filing for divorce, Donald Hess allegedly transferred ninety-two percent of the stock in Hess Holdings, which is estimated to be worth over $200 million, to an offshore trust in Gibraltar.[22] Despite the $600,000 Joanna Hess has spent in legal fees, she has failed in her attempts to assert a claim on the assets.[23]

Asset protection trusts also create fundamental problems for our society. Professor Lynn LoPucki stated the problem succinctly in a 1996 *Yale Law Journal* article:

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15. Trusts Act § 12(4) (1992) (Belize), *reprinted in* 1 INTERNATIONAL TRUST LAWS AND ANALYSIS, *supra* note 11, at BEL 113.
16. ALASKA STAT. § 34.40.110 (Lexis 1998).
17. ALASKA STAT. § 13.36.035 (Lexis 1998).
18. *Id.*
19. *Id.*
20. *Id.*
21. *See* William C. Symonds, *Salting it Away in Margaritaville*, BUS. WK., Aug. 3, 1998, at 61.
22. *See id.*
23. *See id.*

> Law is a system for controlling human behavior. In contemporary society, governments enforce law by essentially two mechanisms: incarceration and liability. These roughly correspond to the two spheres of the legal system: the criminal and the civil. In the criminal sphere, the wrongdoer is threatened with imprisonment; in the civil sphere, the wrongdoer is threatened with deprivation of wealth. Liability is crucial because it is one of only two principal means by which governments enforce law.
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> The liability system enforces liability through the entry and forcible collection of judgments for the payment of money. Although liability is most closely associated with products liability and other tort actions, money judgments are also the means for enforcing contracts, civil rights, labor and employment law, environmental regulations, federal tax law, intellectual property law, most kinds of property rights, and just about every other kind of law on the books. Without liability, the American legal system would be radically different.
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> ....
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> The system by which money judgments are enforced is beginning to fail. The immediate cause is the deployment of legal structures that render potential defendants judgment proof.[24]

Professor LoPucki recognizes offshore trusts as one of the leading judgment proofing legal strategies.[25]

As the use of asset protection trusts grows, governments will respond. An orderly system of liability is too important to society to allow vast amounts of wealth to be placed out of the reach of creditors. However, to date, governments have not taken action. Individual creditors are left to pursue their remedies in both bankruptcy and nonbankruptcy forums.

Faced with an increasing number of debtors who have transferred assets to asset protection trusts, judges, in particular bankruptcy judges, will have a difficult time accepting that creditors are without a remedy while a debtor retains an interest in substantial assets. This Article discusses several issues a court may face in addressing this problem and three recent cases on offshore trusts. The focus of this Article is on a debtor in a bankruptcy case. In part, this is because the few cases on this subject have been brought in bankruptcy courts. In addition, from a creditor's perspective there are advantages in pursuing assets in a protective trust in a bankruptcy court, such as the bankruptcy court's nationwide jurisdiction over persons and worldwide jurisdiction over property of the bankruptcy estate. Many of the arguments should be applicable in state courts as well.

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24. LoPucki, *supra* note 1, at 3-4.
25. *See id.*

II. THE CODE

How does the Bankruptcy Code treat spendthrift trusts? Under the Code, "[t]he nature and extent of the debtor's interest in property is determined by applicable non-bankruptcy law. Whether that interest is included in the property of the debtor's estate is determined by bankruptcy law."[26] Bankruptcy Code section 541(a)(1) provides that property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[27] Thus, "[u]nder paragraph (1) of subsection (a), the estate is comprised of all legal or equitable interest of the debtor in property, wherever located, as of the commencement of the case. The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property . . . ."[28]

Bankruptcy Code section 541(c)(2) provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title."[29] Subsection (c)(2) "preserves restrictions on transfer of a spendthrift trust to the extent that the restriction is enforceable under applicable non-bankruptcy law."[30] Thus, under subsection (c)(2), if applicable nonbankruptcy law provides that the assets of a trust are protected from the claims of a debtor-beneficiary's creditors, i.e., that the trust is a valid spendthrift or other protective trust, the assets of such trust may not be property of a bankruptcy estate and may be excepted from the reach of Code section 541(a)(1). However, if under applicable nonbankruptcy law the assets of a trust are subject to the claims of a debtor-beneficiary's creditors, i.e., the trust is not a valid spendthrift or other protective trust, the assets of such trust are property of the bankruptcy estate.[31]

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26. Official Comm. of Unsecured Creditors v. PSS Steamship Co. (*In re* Prudential Lines, Inc.), 928 F.2d 565, 569 (2d Cir. 1991). *See also* Butner v. United States, 440 U.S. 48, 54 (1979).

27. 11 U.S.C. § 541(a)(1) (1994).

28. H.R. REP. NO. 95-595, at 367 (1977); S. REP. NO. 95-989, at 82 (1978).

29. 11 U.S.C. § 541(c)(2).

30. H.R. REP. NO. 95-595, at 369 (1977). *See also* S. REP. NO. 95-989, at 83 (1978).

31. *See, e.g., In re* Spenlinhauer, 182 B.R. 361, 364-65 (Bankr. D. Me. 1995), *aff'd*, 195 B.R. 543 (D. Me. 1996) (holding that debtor-settlor-beneficiary's interest in income and principal of trust included in bankruptcy estate where anti-alienation provisions of trust were not enforceable under Maine law); *In re* Baldwin, 142 B.R. 210, 214-15 (Bankr. S.D. Ohio 1992) (finding that assets of trust of which debtor was beneficiary were property of the bankruptcy estate where trust not a valid spendthrift trust under Ohio law).

The critical question in the context of asset protection trusts is what is the applicable nonbankruptcy law?

III. JURISDICTION

Before reaching the choice of law issue, a bankruptcy court must determine whether it has jurisdiction to decide whether property held in an asset protection trust is property of a bankruptcy estate. As noted, asset protection trust agreements and the laws of asset protection jurisdictions typically include a provision stating that the courts of the chosen asset protection jurisdiction have exclusive jurisdiction over the assets in a trust. In addition, it will be difficult or impossible for a U.S. court to obtain personal jurisdiction over an offshore trustee. How does a bankruptcy court enter orders with respect to the property in a trust in the face of such trust provisions and laws?

28 U.S.C. section 1334(e) provides: "The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate."[32] As the Second Circuit Court of Appeals has stated, "[i]t is well established that a bankruptcy court has jurisdiction over all of the property of the debtor's estate, wherever located."[33] "[L]egislative history makes clear Congress' intent that 'wherever located' language be broadly construed to include property located in *and outside of the U.S.*"[34] Thus, if the property transferred to an asset protection trust is

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32. 28 U.S.C. § 1334(e) (1994).

33. MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988).

34. *In re* Nakash, 190 B.R. 763, 768 (Bankr. S.D.N.Y. 1996) (emphasis added). *See also In re* Lykes Bros. S.S. Co., 191 B.R. 935, 936 (Bankr. M.D. Fla. 1995) (holding that bankruptcy court had *in rem* jurisdiction over chapter 11 debtor's properties, wherever located, even though debtor was operator of merchant fleet whose operation extended worldwide); Coan v. Bernier (*In re* Bernier), 176 B.R. 976, 984 (Bankr. D. Conn. 1995) ("[I]t is observed that the district court, of which this court is a unit, . . . has exclusive jurisdiction over all property of the bankruptcy estate, *see* 28 U.S.C. § 1334(e) . . . ."); *In re* Comstock Fin. Servs., Inc., 111 B.R. 849, 855 (Bankr. C.D. Cal. 1990) ("Through 28 U.S.C. § 1334(d), Congress has placed exclusive jurisdiction over property of bankruptcy estates in United States District Courts. Congress has authorized district courts to refer this *in rem* jurisdiction, as well as the subject matter jurisdiction granted by Congress in 28 U.S.C. 1334(a), to United States Bankruptcy Courts."); Deak & Co. v. Ir. R.M.P. Soedjono (*In re* Deak & Co.), 63 B.R. 422, 427-28 (Bankr. S.D.N.Y. 1986) (finding that shares of stock owned or controlled by debtor were property of estate providing bankruptcy court with *in rem* jurisdiction in adversary proceeding to declare stock pledge a voidable preference, notwithstanding that shares were located beyond the borders of the United States).

property of a bankruptcy estate, federal law provides that the bankruptcy court has jurisdiction over such property. In addition, the bankruptcy court has jurisdiction to determine whether the property transferred to an asset protection trust is property of a bankruptcy estate.[35] The bankruptcy court will have personal jurisdiction over any domestic trustee.[36] Further, in order to enter a judgment that the property transferred to an asset protection trust is property of a bankruptcy estate, the bankruptcy court does not need *in personam* jurisdiction over an offshore trustee.[37]

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35. *See, e.g.*, Ebel v. Ebel (*In re* Ebel), 144 B.R. 510, 514 (D. Colo. 1992) ("As of the date of the filing of the petition, the bankruptcy court had absolute authority and jurisdiction to determine what property belonged to the estate itself."); Walsh v. Pennsylvania (*In re* Kingsley), 181 B.R. 225, 233 (Bankr. W.D. Pa. 1995) ("We unquestionably have jurisdiction to determine what property is property of this bankruptcy estate and to direct turnover if bankruptcy property is withheld."); DiBerto v. The Meadows at Madbury, Inc. (*In re* DiBerto), 171 B.R. 461, 475 (Bankr. D.N.H. 1994) ("[T]he Court clearly has jurisdiction to determine what is and what is not property of the estate."); *In re* Duval County Ranch Co., 167 B.R. 848, 849 (Bankr. S.D. Tex. 1994) ("Whenever there is a dispute regarding whether property is property of the bankruptcy estate, exclusive jurisdiction is in the bankruptcy court."); Cole Taylor v. Ratner (*In re* Ratner), 146 B.R. 211, 214-15 (Bankr. N.D. Ill. 1992) ("[T]he bankruptcy court always has jurisdiction to determine what is, or is not, property of the bankruptcy estate under 11 U.S.C. § 541.").

36. *See, e.g.*, FED. R. BANKR. P. 7004(d), 7004(e); Diamond Mortgage Corp. v. Sugar, 913 F.2d 1233, 1244 (7th Cir. 1990); American Freight Sys. v. W.A. Walker Assocs., (*In re* American Freight Sys., Inc.), 153 B.R. 316, 321 (D. Kan. 1993) (stating that "minimum contacts with the forum state are unnecessary" when service is made under a federal service provision); General Am. Communications Corp. v. Landsell (*In re* General Am. Communications Corp.), 130 B.R. 136, 160 (S.D.N.Y. 1991) ("The 'minimum contact test,' applied to a State and a defendant, has no relevance here because . . . § 1334 provides us with 'federal question' jurisdiction."); Hirsch v. Vlerbaum (*In re* Colonial Realty Co.), 163 B.R. 431, 433 (Bankr. D. Conn. 1994) ("The defendant admits that he is a resident of Ohio. Therefore, there can be no question that the defendant has sufficient contacts with the United States for a federal court constitutionally to exercise personal jurisdiction over him."); Teitelbaum v. Choquette & Co. (*In re* Outlet Dep't Stores), 82 B.R. 694, 699 (Bankr. S.D.N.Y. 1988) ("[I]n federal question cases, where nationwide service of process is permitted, the 'minimum contacts' test set forth in *International Shoe* does not apply.").

37. *See, e.g.*, O'Brien v. Vermont (*In re* O'Brien), 216 B.R. 731, 737 (Bankr. D. Vt. 1998). The Bankruptcy Court in *O'Brien* stated that:

> Our *in rem* jurisdiction over property of the debtor and the estate empowers us
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> > to determine[ ] all claims that anyone, whether named in the action or not, has to the property or thing in question. The proceeding is one 'against the world.' The practical effect of such an action is to establish an unquestionable title to the property because no one can later claim exemption from the effect of the judgment on the ground that the court lacked jurisdiction.

A bankruptcy court clearly has *in rem* jurisdiction to make a determination whether property held in an asset protection trust is property of a bankruptcy estate. If a bankruptcy court determines that property held in an asset protection trust is property of a bankruptcy estate, it has jurisdiction over that property, irrespective of whether it has *in personam* jurisdiction over the trustee.

IV. CHOICE OF LAW ISSUES

As noted above, in the asset protection trust context the critical question is: what is the applicable nonbankruptcy law? With an asset protection trust, there are usually two possibilities as to the applicable nonbankruptcy law under Code section 541(c)(2). Either the law of the home state of the settlor or the law of the asset protection trust jurisdiction applies to determine the validity of the trust.

All states in the United States recognize, to one degree or another, trust provisions protecting trust assets or income from the claims of creditors. Approximately one-half of the states have enacted some type of spendthrift legislation, and courts in all of the remaining states, other than New Hampshire, enforce spendthrift provisions under common law principles.[38] However, "[t]here is . . . one universally accepted exception to the spendthrift trust doctrine: state courts and federal bankruptcy courts will not enforce a spendthrift provision in a self-settled trust."[39] Restatement (Second) of Trusts section 156 states the general rule followed in most U.S. jurisdictions:

Id. (quoting 16 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE 108-106 (3d ed. 1997)). *See also,* Pan Am. World Airways, Inc. v. Care Travel Co. (*In re* Pan Am Corp.), 166 B.R. 538, 542 (S.D.N.Y. 1993); Tamposi v. FDIC (*In re* Tamposi Family Inv. Properties), 159 B.R. 631, 637 (Bankr. D.N.H. 1993); Whitlock v. Worrall (*In re* Am. Aluminum Window Corp.), 15 B.R. 803, 805 (Bankr. D. Mass. 1981) ("[T]he recovery of a preference requires an in rem jurisdiction over the property of the estate and not necessarily an in personam jurisdiction over the Defendant . . . .").

38. *See* Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 29 (1994).

39. *Id.* at 29-30. *See also* Robbins v. Webster (*In re* Robbins), 826 F.2d 293, 295 (4th Cir. 1987) ("The general rule is stated in Restatement (Second) of Trusts § 156(2) (1957). The creditors of a settlor may reach the assets of a spendthrift trust to the maximum extent that the trustee might apply them for the use and benefit of the settlors."); *In re* Spenlinhauer, 182 B.R. 361,363-64 (Bankr. D. Me. 1995), *aff'd*, 195 B.R. 543 (D. Me. 1996) ("The principles that determine the unenforceability of transfer restrictions on a self-settled spendthrift trust are axiomatic."); Parkinson v. Brandford Trust Co. (*In re* O'Brien), 50 B.R. 67, 75-76 (Bankr. E.D. Va. 1985) (Virginia law); *In re* Berndt, 34 B.R. 515, 518 (Bankr. N.D. Ind. 1983) (Indiana law); Jensen v. Hall (*In re* Hall), 22 B.R. 942, 944 (Bankr. M.D.

> (1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his . . . creditors can reach his interest.
> (2) Where a person creates for his own benefit a trust for support or a discretionary trust, his . . . creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.[40]

As noted above, offshore jurisdictions, Alaska, and Delaware all protect self-settled spendthrift trusts. Thus, if the law of the asset protection jurisdiction applies, the assets in the trust will be protected, i.e., the spendthrift provision of a self-settled trust will be found valid. If the law of the settlor's home state applies, the assets will be subject to the claims of creditors and will be property of a bankruptcy estate or otherwise available to satisfy the claims of creditors, i.e., the spendthrift provision of a self-settled trust may be found invalid.

As an initial matter, there are two possibilities as to the choice of law rule to apply. The Second Circuit Court of Appeals has described the two possibilities as follows:

> Federal Courts sitting in diversity jurisdiction are required by *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487, 496 (1941), to apply the choice-of-law doctrines of the forum state. Many bankruptcy courts have read *Klaxon* as imposing the forum state's choice-of-law rule on bankruptcy adjudications where the underlying rights and obligations are defined by state law. In contrast, federal principles should guide our consideration of which jurisdiction's substantive law applies in cases arising out of federal law. This is especially appropriate when a case involves controversies implicating important federal bankruptcy policy.[41]

There is a strong argument that the question of whether property transferred to an asset protection trust is property of a bankruptcy estate raises a federal question, so that federal choice of law rules govern the choice of substantive law. A proceeding to determine what constitutes property of the estate pursuant to Bankruptcy Code section 541 is a core proceeding under 28 U.S.C. section 157(b)(2)(A) and (E).[42] A proceeding is a core

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Fla. 1982) ("It is uniformly held that when a spendthrift trust is created in which part or all of the beneficial interest is reserved in the creator of the trust, the restraint [on alienation] is invalid and the creditors of the creator may reach his interest."); Samore v. Graham (*In re* Graham), 24 B.R. 305, 310 (Bankr. N.D. Iowa 1982), *aff'd*, 726 F.2d 1268 (8th Cir. 1984) (Iowa law); Greenwich Trust Co. v. Tyson, 27 A.2d 166, 170-73 (Conn. 1942) (Connecticut law).

40. RESTATEMENT (SECOND) OF TRUSTS § 156 (1959).

41. Koreag, Controle et Revision S.A. v. Refco F/X Assocs. (*In re* Koreag, Controle et Revision S.A.), 961 F.2d 341, 350 (2d Cir. 1992), *cert. denied*, 506 U.S. 865 (1992) (citations omitted).

42. *See, e.g.*, *In re* Becker, 136 B.R. 113, 116-17 (Bankr. D.N.J. 1992); Rodeck v. Olszewski (*In re* Olszewski), 124 B.R. 743, 745 (Bankr. S.D. Ohio 1991) ("The portion of the proceeding over which the court has jurisdiction involves a

proceeding if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case.[43] Further, while the extent of a debtor's interest in property is determined by applicable nonbankruptcy law, it is well established that whether property is property of a bankruptcy estate is a question of federal law.[44] Core proceedings, including actions to determine whether property is property of a bankruptcy estate, raise federal questions of law and federal common law choice of law rules should apply.[45]

"The federal common law choice-of-law rule is to apply the law of the jurisdiction having the greatest interest in the litigation."[46] In applying this greatest or "most significant" interest approach, federal courts follow the Restatement (Second) of Conflict of Laws.[47] Even assuming federal common law choice of law rules are not applicable, the choice of law rule in most states, including New

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determination of whether certain assets are assets of debtor's bankruptcy estate and is, therefore, a core proceeding under 28 U.S.C. § 157(b)(2)(A).").

43. *See, e.g.*, Torkelsen v. Maggio *(In re* Guild and Gallery Plus, Inc.), 72 F.3d 1171, 1178 (3d Cir. 1996).

44. *See, e.g.*, Marrs-Winn Co. v. Giberson Elec., Inc. *(In re* Marrs-Winn Co.), 103 F.3d 584, 591 (7th Cir. 1996) ("The question of whether a debtor's interest in property is 'property of the estate' is a federal question to be decided by federal law."); Ralar Distribs., Inc. v. Rubbermaid, Inc. *(In re* Ralar Distribs., Inc.), 4 F.3d 62, 67 (1st Cir. 1993) ("What constitutes 'property,' within the meaning of Bankruptcy Code § 541, is a question of federal law . . . ."); Southtrust Bank v. Thomas, 883 F.2d 991, 995 (11th Cir. 1989) ("'[W]hether an interest of the debtors is property of the estate is a federal question.'" (quoting *In re* DePoy, 29 B.R. 466, 469 (Bankr. N.D. Ind. 1983)); Amdura Nat'l Distrib. Co. v. Amdura Corp. *(In re* Amdura Corp.), 167 B.R. 640, 644 (D. Colo. 1994) ("[T]he extent to which a debtor's interest in property creates 'property of the estate' for turnover purposes is a question of federal law.") (citations omitted); *In re* Becker, 136 B.R. at 116 ("[T]he question of what constitutes property of a bankruptcy estate is ultimately a federal question.") (citations omitted).

45. *See, e.g.*, Committee of Unsecured Creditors v. RG Fin., Ltd. *(In re* Powerburst Corp.), 154 B.R. 307, 310 (Bankr. E.D. Cal. 1993) ("As core proceedings in bankruptcy are federal questions, this Court finds and holds that the federal common law choice of law rules apply in this instance.").

46. *In re Koreag*, 961 F.2d at 350.

47. *See, e.g.*, Pescatore v. Pan Am. World Airways, Inc., 97 F.3d 1, 12 (2d Cir. 1996) ("In the absence of Congressional guidance, we have from time to time consulted the [RESTATEMENT (SECOND) OF CONFLICT OF LAWS] (1971) in fashioning that federal rule."); Schoenberg v. Exportadora de Sal, S.A. de C.V., 930 F.2d 777, 782 (9th Cir. 1991) ("Federal common law follows the approach of the [RESTATEMENT (SECOND) OF CONFLICT OF LAWS] (19[71])."), *cert. denied*, 513 U.S. 1018 (1994); *In re* Catfish Antitrust Litigation, 908 F. Supp. 400, 411 (N.D. Miss. 1995) ("Federal conflicts of law rules are those of the [RESTATEMENT (SECOND) OF CONFLICT OF LAWS].").

York and Connecticut, is now the Restatement's "most significant interest" test.[48]

Under the most significant interest test, a designation in a trust which provides that a certain law be applied to interpret the trust is generally respected.[49] "For the most part, it is immaterial whether the forum designated for purposes of *construing* the trust provisions has any connection with the creation or the administration of the trust."[50] However, "for purposes of determining the *validity* of a trust, the settlor has 'not as free a hand.'"[51]

> The chief purpose in making decisions as to the applicable law is to carry out the intention of the creator of the trust in the disposal of his property. *It is important that his intention, to the extent to which it can be ascertained, should not be defeated, unless this is required by the policy of a state which has such an interest in defeating his intention, as to the particular issue involved, that its local law should be applied.*[52]

As to a trust's validity, the Restatement provides:

> An inter vivos trust of interests in movables is valid if valid
> (a) under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6 . . . .[53]

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48. *See, e.g.*, Valley Juice Ltd. v. Evian Waters of France, Inc., 87 F.3d 604, 609 (2d Cir. 1996) ("In applying contractual choice of law provisions, Connecticut courts routinely refer to the *Restatement* for guidance.") (citations omitted); Economu v. Borg-Warner Corp., 652 F. Supp. 1242, 1246-49 (D. Conn. 1987) (finding that the Connecticut choice of law rule in a case involving contract, tort and fraud claims is the Restatement's most significant interest test), *aff'd*, 829 F.2d 311 (2d Cir. 1987); Marine Midland Bank v. Portnoy (*In re* Portnoy), 201 B.R. 685, 697 (Bankr. S.D.N.Y. 1996) ("New York law . . . provides that 'the law of the jurisdiction having the greatest interest in the litigation will be applied . . . .'") (citations omitted).

49. *See In re* Portnoy, 201 B.R. at 697; 5A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 575, at 201 (4th ed. 1987).

50. *In re* Portnoy, 201 B.R. at 697.

51. *Id.* (quoting SCOTT & FRATCHER, *supra* note 49, § 575, at 201-02).

52. *Id.* (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 267 (1971)) (emphasis added). *See also* SCOTT & FRATCHER, *supra* note 49, § 553, at 110-11 ("In the making of a contract, the conflicting interests of two or more parties are involved, whereas in the creation of a trust the intention of the settlor or testator is the only important consideration, except insofar as some public policy may defeat his intention.").

53. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 270. Section 6(2) of the Restatement provides:

> When there is no such [statutory] directive [on choice of law], the factors relevant to the choice of the applicable rule of law include

For example, when determining the validity of a trust, the local law of the designated state will not be applied if this would violate a strong public policy of the state with which, as to the matter in issue, the trust has its most significant relationship. For example, where the settlor creates a revocable trust in a state other than that of his domicil, in order to avoid the application of the local law of his domicil giving his surviving spouse a forced share of his estate, it may be held that the local law of his domicil is applicable, even though he has designated as controlling the local law of the state in which the trust is created and administered.[54]

In many cases, the asset protection trust's most significant relationship will be with the home state of the settlor. The asset protection jurisdiction will have a relationship to the asset protection trust in that the trust will have been settled in the asset protection jurisdiction, residents of the asset protection jurisdiction will have been appointed as trustees of the trust, and the trust is to be administered in the asset protection jurisdiction. However, the debtor, who typically is both the settlor and, during his life the beneficiary of the trust, the majority of the debtor's creditors, and the majority of the beneficiaries of the trusts upon the death of the debtor, are often residents of the debtor's home state or at least of the United States. Typically, the debtor's creditors will have no contacts with the asset protection jurisdiction, and the debtor will have had the greatest contact with the home state at the time he settled the trust. In these circumstances, the home jurisdiction has the weightier concern in determining whether or not whatever rights the debtor retained after the formation of the trust could be considered to constitute a property interest.

Where an asset protection trust is self-settled, application of the law of the asset protection jurisdiction would offend strong state and federal bankruptcy policies. As noted, Alaska and Delaware notwithstanding, state courts and federal bankruptcy courts will not enforce a spendthrift provision in a self-settled trust. For example, under Connecticut law, it is against public policy to permit a settlor-beneficiary to tie up his property in such a way that he can still enjoy it but can prevent his creditors from

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(a) the needs of the interstate and international systems,
(b) the relevant policies of the forum,
(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
(d) the protection of justified expectations,
(e) the basic policies underlying the particular field of law,
(f) certainty, predictability and uniformity of result, and
(g) ease in the determination and application of the law to be applied.

54. *See id.* § 270, cmt. b.

reaching it.[55] In *Greenwich Trust Co. v. Tyson*, the Connecticut Supreme Court stated:

> The attempt of a man to place his property in trust for his own benefit under limitations similar to those which characterize a spendthrift trust is a departure from the underlying basis for the creation of such trusts. That aside, the public policy which sustains such trusts when created for the benefit of another is, where the settlor is himself the beneficiary, overborne by other considerations. In *Johnson v. Connecticut Bank*, 21 Conn. 148, 159, where we were considering the right of the creditor of a beneficiary of a trust to secure satisfaction from the latter's right to the income, we stated: "It is the policy of our law, that *all* the property of a debtor should be responsible for his debts. And his equitable estate may be taken, as well as his legal, provided it is subject to his control"; and, subject to definite limitations, that has always been the policy of our law. To admit the validity of such trusts would open too wide an opportunity for a man to evade his just debts to be permissible unless sanctioned by statutory enactment. This is the reason why the overwhelming weight of authority holds ineffective attempts to establish them.[56]

There is a second basis upon which to apply the law of the settlor's home state.

> Under normal circumstances, contracting parties are free to stipulate what state's or nation's law will govern their contractual rights and duties, provided that the state or nation has a reasonable relationship with the transaction, and the law chosen does not violate a fundamental public policy of the forum state. Nonetheless, the parties' stipulation will not be regarded where it would operate to the detriment of strangers to the agreement, such as creditors or lienholders. Where the rights of third parties are implicated, the court should be governed by the ordinary rule that the federal district courts apply the choice of law rules of the state in which they sit.[57]

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55. *See* Greenwich Trust Co. v. Tyson, 27 A.2d 166, 171 (Conn. 1942); *In re* Tisdale, 112 B.R. 61, 65 (Bankr. D. Conn. 1990) ("The Connecticut Supreme Court, in *Greenwich Trust Co. v. Tyson*, 129 Conn. 211, 219, 27 A.2d 166,171 (1942), ruled that public policy denied the validity of a trust where a person placed 'his property in trust for his own benefit under limitations similar to those which characterize a spendthrift trust.' This holding is in accordance with prevailing law throughout the United States.").

56. *Greenwich Trust Co.*, 27 A.2d at 171 (emphasis added) (citations omitted).

57. Hong Kong and Shanghai Banking Corp., v. HFH USA Corp., 805 F. Supp. 133, 139-40 (W.D.N.Y. 1992). *See also* Exec Tech Partners v. Resolution Trust Corp. (*In re* Exec Tech Partners), 107 F.3d 677, 681 (8th Cir. 1997) ("A contract generally binds no one except the parties."); *In re* Kokomo Times Publ'g and Printing Corp., 301 F. Supp. 529, 536 (S.D. Ind. 1968) ("[T]he parties could not by agreement make Illinois law bind creditors and purchasers who were not parties to the agreement."); Marine Midland Bank v. Portnoy (*In re* Portnoy), 201 B.R. 685, 701 (Bankr. S.D.N.Y. 1996); Ferrari v. Barclays Bus. Credit, Inc. (*In re*

Thus, a debtor "may not unilaterally remove the characterization of property as his simply by incorporating a favorable choice of law provision into a self-settled trust of which he is the . . . beneficiary. Equity would not countenance such a practice."[58]

The scope of a settlor's choice of law should be limited to issues relating to the internal affairs of the trust. Neither the settlor nor the trustee should be able to bind third party creditors who are not parties to the trust agreement.

V. DOMESTIC ASSET PROTECTION TRUSTS AND FULL FAITH AND CREDIT

If a bankruptcy trustee or a creditor obtains a judgment from a bankruptcy court that assets in a domestic asset protection trust are assets of the bankruptcy estate, the bankruptcy trustee or creditor should be able to pursue effective remedies against the trust trustee, including a turnover action under Bankruptcy Code section 542.[59] As noted above, the bankruptcy court will have personal jurisdiction over the domestic trust trustee, so that a judgment determining that property is property of a bankruptcy estate and a judgment ordering turnover of such property would be binding on the trust trustee. Further, the bankruptcy trustee or creditor should be able to enforce any such judgment in the courts of the asset protection trust jurisdiction. The enforceability of a Bankruptcy Code sections 541 or 542 judgment and the

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Morse Tool, Inc.), 108 B.R. 384, 386 (Bankr. D. Mass. 1989) *modified*, 148 B.R. 97 (Bankr. D. Mass. 1992). The *Ferrari* Court stated that:

> The choice-of-law clause carries little weight in the context of this adversary proceeding. The parties to a contract can specify which forum's law will govern their contract, and courts often follow their choice because both parties to the contract, and therefore to the suit on the contract, have agreed upon the choice. But this is a fraudulent conveyance action, not a contract action. And one of the parties to this suit—the Trustee, who stands in the shoes of the creditors—was not a party to the contract. The parties to a contractual conveyance cannot in their contract make a choice-of-law that binds creditors who allege that they were defrauded by the conveyance. The choice-of-law binds only parties to the contract, not the Trustee or the creditors.

Id.

58. *In re* Portnoy, 201 B.R. at 701.

59. Bankruptcy Code section 542(a) provides in relevant part:

> . . . [A]n entity . . . in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title . . . shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a) (1994).

enforcement of such a judgment in the courts of the domestic asset protection jurisdiction would not be prevented by and, indeed, would be supported by principles of full faith and credit.

"Our precedent differentiates the credit owed to laws (legislative measures and common law) and to judgments."[60] The "Full Faith and Credit Clause does not require a State to apply another State's [statutory] law in violation of its own legitimate public policy."[61]

> [I]n the case of statutes, the extrastate effect of which Congress has not prescribed, as it may under the constitutional provision, we think the conclusion is unavoidable that the full faith and credit clause does not require one state to substitute for its own statute, applicable to persons and events within it, the conflicting statute of another state, even though that statute is of controlling force in the courts of the state of its enactment with respect to the same persons and events.[62]

The Supreme Court has concluded that "Full faith and credit does not here enable one state to legislate for the other or to project its laws across state lines so as to preclude the other from prescribing for itself the legal consequences of acts within it."[63]

However, the full faith and credit obligation is more exacting in the case of judgments.

> A final judgment in one State, if rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, qualifies for recognition throughout the land. For claim and issue preclusion (res judicata) purposes, in other words, the judgment of the rendering State gains nationwide force.[64]

While "a court may be guided by the forum State's 'public policy' in determining the *law* applicable to a controversy . . . [the Supreme Court's] decisions support no roving 'public policy exception' to the full faith and credit clause."[65] Thus, absent fraud or lack of personal or subject matter jurisdiction, the courts of a state must recognize a judgment from a state or federal court in another state, even if such judgment is not consistent with local policy or law.

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60. Baker v. General Motors Corp., 118 S. Ct. 657, 663 (1998).
61. Nevada v. Hall, 440 U.S. 410, 422 (1979).
62. Pacific Ins. Co. v. Industrial Accident Comm'n, 306 U.S. 466, 502 (1939).
63. *Id.* at 504-05.
64. *Baker*, 118 S. Ct. at 663-64.
65. *Id.* at 664. *See also* Estin v. Estin, 334 U.S. 541, 546 (1948) (stating that the Full Faith and Credit clause "ordered submission . . . even to hostile policies reflected in the judgment of another State, because the practical operation of the federal system, which the Constitution designed, demanded it.").

As noted, in the case of a domestic asset protection trust, the bankruptcy court will have personal jurisdiction over the trust trustee. Absent fraud, full faith and credit would mandate that a bankruptcy court judgment, finding a trust invalid pursuant to the law of the forum state, would be enforceable in the asset protection jurisdiction, even though the trust would be valid under the law of the asset protection jurisdiction.

VI. *PORTNOY, BROOKS,* AND *LAWRENCE*

Three recent cases address the validity of offshore trusts. The first, *Marine Midland Bank v. Portnoy (In re Portnoy)*,[66] involved one Larry Portnoy, who was the president and sole shareholder of a company named Mary Drawers.[67] In March 1987, Portnoy gave Marine Midland Bank a guarantee of any existing and future indebtedness of Mary Drawers to Marine Midland.[68] In March 1988, Marine Midland loaned $1 million to Mary Drawers.[69]

In June 1989, Portnoy knew Mary Drawers was in trouble.[70] In August 1989, Portnoy established a trust in Jersey, Channel Islands, naming himself as principal beneficiary and his two children as additional beneficiaries.[71] The trust agreement provided that the trust would be governed by Jersey law and purported to vest exclusive jurisdiction over the trust's interpretation in Jersey courts.[72] Portnoy retained substantial control over the trust assets.[73] The Jersey trustee had no office, telephone listing, or employees in the United States.[74] Over several months following the establishment of the trust, Portnoy transferred assets worth approximately $700,000 to the trust.[75]

In November 1995, Portnoy filed a chapter 7 petition.[76] He did not list the property held in the trusts in his schedules.[77] Marine Midland filed an action under, *inter alia*, Bankruptcy Code section 727 seeking to deny Portnoy his discharge, alleging that Portnoy had intentionally or recklessly omitted from his

66. 201 B.R. 685 (Bankr. S.D.N.Y. 1996).
67. *See id.* at 688-89.
68. *See id.* at 689.
69. *See id.*
70. *See id.*
71. *See id.*
72. *See id.*
73. *See id.*
74. *See id.*
75. *See id.* at 690.
76. *See id.* at 691.
77. *See id.*

schedules his interest in the property transferred to the trust.[78] Portnoy filed a motion for summary judgment, alleging, *inter alia*, that the assets transferred to the trusts were no longer his property at the time the petition was filed, so that he was not obligated to list the property in his schedules.[79]

The court found that it had jurisdiction to determine whether the assets transferred to the Jersey trust were property of the estate.[80] Turning to the issue of whether Portnoy had a property interest in the trust, the court noted that while property interests are created and defined by state law, it is federal bankruptcy law which determines the "outer boundary" of what may constitute property of the estate pursuant to Bankruptcy Code section 541.[81] The court found that it did not have to determine whether federal or New York choice of law principles should be used to determine the applicable local law, as both provide that the law of the jurisdiction having the greatest interest in the litigation will be applied.[82] The court stated that while both federal and New York choice of law principles respect a designation in a trust which provides that a certain law be applied to interpret the trust, a settlor is not as free to designate the law to be applied for purposes of determining the validity of a trust.[83] The court, quoting Restatement (Second) of Conflict of Laws section 270, found that a trust is valid if considered so "under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and the application of its law does not violate a strong

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78. *See id.* at 688. Bankruptcy Code section 727(a) provides in part:

> The court shall grant the debtor a discharge unless—
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> . . . .
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with the custody of property under this title, has transferred, removed, destroyed, mutilated or concealed, or has permitted to by transferred, removed, destroyed, mutilated, or concealed—
>
> (A) property of the debtor, within one year before the date of the filing of the petition; or
>
> . . . .
>
> (4) the debtor knowingly and fraudulently, in or in connection with the case—
>
> (A) made a false oath or account . . . .

11 U.S.C. § 727(a) (1994).

79. *See In re* Portnoy, 201 B.R. at 692.
80. *See id.* at 696.
81. *See id.*
82. *See id.* at 697.
83. *See id.*

public policy of the state with which, as to the matter at issue, the trust has its most significant relationship . . . ."[84]

The court found that because Portnoy, Portnoy's creditors, and the other beneficiaries of the trust were all United States domiciliaries, Portnoy's creditors had no contacts with Jersey, and Portnoy had the greatest contact with the United States at the time he settled the trust, New York had the most significant relationship with the litigation.[85] In concluding that self-settled trusts are not valid under New York law, the court stated that

> it probably goes without saying that it would offend our policies to permit a debtor to shield from creditors all of his assets because ownership is technically held in a self-settled trust, where the settlor/beneficiary nonetheless retains control over the assets and may effectively direct disposition of those assets . . . .
>
> In the United States, it has long been held that "[i]t is against public policy to permit the owner of property to create for his own benefit an interest in that property that cannot be reached by his creditors." . . . .
>
> On the other hand, it is not at all clear what the policy behind the Jersey [law] is except, perhaps, to augment business.[86]

The court also found that Portnoy could not bind creditors with the choice of law provision in the trust agreement.[87] The court stated that "the only person that is a party to this choice of law provision is Portnoy himself."[88] The court concluded that the property transferred to the trusts was property of the bankruptcy estate and for that, and other reasons, denied the motion for summary judgment.[89]

The second recent offshore trust case, *Sattin v. Brooks (In re Brooks)*,[90] involved a debtor who owned stock in a number of Connecticut corporations.[91] The corporations owned real estate and community newspapers located in Connecticut. In the spring and summer of 1990, the debtor transferred his stock to his wife.[92] His wife then transferred the stock to offshore trusts located in Jersey, Channel Islands, and Bermuda.[93] The Jersey and Bermuda trust agreements included choice of law provisions designating Jersey and Bermuda law as the applicable law for

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84. *Id.* at 697-98 (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAW § 270 (1971)).

85. *See id.* at 698.

86. *Id.* at 700 (quoting 2A SCOTT & FRATCHER, *supra* note 49, § 156, at 168).

87. *See id.* at 701.

88. *Id.*

89. *See id.* at 703.

90. 217 B.R. 98 (Bankr. D. Conn. 1998).

91. *See id.* at 101.

92. *See id.*

93. *See id.*

interpreting the trusts.[94] Each trust agreement named the debtor as the sole income beneficiary and permitted the distribution to the debtor of as much of the principal of each trust as each trustee deemed "necessary, advisable or appropriate for his health, comfort, support, and for his needs in connection with any enterprise in which he may be engaged either personally or as an investor (without any duty to take into account other resources of [the debtor]) . . . ."[95]

The court stated that the parties agreed that Connecticut's choice of law rules were applicable for determining the applicable nonbankruptcy law.[96] The court found that

> Connecticut courts generally "respect the expressed will of the settlor [of a trust] as to the controlling law." There are, however, exceptions. Connecticut courts have held that "the legality of the trust of personalty [is determined] by the law of the settlor's domicil . . . ." Moreover, Connecticut will not "enforce the law of another jurisdiction nor the rights arising thereunder, which . . . contravene [Connecticut] public policy." Here, because stock certificates are personalty, the settlor resides in Connecticut, and on the basis of public policy considerations . . . , the enforceability of the spendthrift provisions of the trusts is determined under Connecticut law.[97]

The court held that the debtor was the settlor of the trusts.[98] The court found that "[a] trust which names the settlor as a beneficiary is invalid to the extent of the settlor's beneficial interest . . . . Those principals have been adopted in nearly every jurisdiction."[99] The court went on to quote comment (e) to section 156(2) of the Restatement (Second) of Conflict of Laws:

> Where by the terms of the trust a trustee is to pay the settlor or apply for his benefit as much of the income or principal as the trustee may in his discretion determine, his transferee or creditors can reach the maximum amount which the trustee could pay to him or apply for his benefit.[100]

The court found that the spendthrift provisions of the trusts were not enforceable under Connecticut law.[101] The court concluded

94. *See id.*
95. *Id.* (quoting Plaintiff's Motion for Summary Judgment at 7-8 (Mar. 20,1997), *In re* Brooks, 217 B.R. 98).
96. *See id.*
97. *Id.* at 101-02 (citations omitted).
98. *See id.* at 102.
99. *Id.* at 103.
100. *Id.* at 104 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 156(2) cmt. e (1971)).
101. *See id.*

that the stock transferred to the offshore trusts was property of the bankruptcy estate.[102]

In the third case, *Goldberg v. Lawrence (In re Lawrence)*, without much *legal* discussion the court adopted the reasoning of *Portnoy* and *Brooks* in finding that the debtor's rights and obligations under a Mauritian trust were governed by Florida and federal bankruptcy law and that the property transferred to the trusts by the debtor was property of the bankruptcy estate.[103] This finding came in the court's order granting discovery sanctions to the chapter 7 trustee-plaintiff in a Code section 727 action.[104] The decision is interesting because of the apparent ease with which the court adopted the reasoning of *Portnoy* and *Brooks* and because of the recitation of facts and the comments made by the court.

Prior to October 19, 1987 (i.e., "Black Monday"), Mr. Lawrence was a successful options trader and had utilized Bear, Stearns & Co., Inc., as his trade clearinghouse.[105] Following the October 19, 1987, crash, the debtor and his companies experienced a margin deficit with Bear, Stearns.[106] On March 15, 1991, an arbitrator found that the debtor and certain of his trading companies owed Bear, Stearns in excess of $20 million.[107] On April 7, 1993, a corrected final judgment in favor of Bear, Stearns against the debtor and certain of his trading companies was entered by the United States District Court for the Southern District of New York in the amount of $20,412,115.[108]

On or about January 8, 1991, just sixty-six days prior to the arbitration award against the debtor, the debtor established a trust in Jersey, Channel Islands.[109] On February 7, 1991, thirty-seven days prior to the arbitration award, the debtor moved the trust to Mauritius and amended the trust agreement to add specific spendthrift trust language.[110]

At trial on the trustee's motion to compel answers to discovery, the debtor repeatedly testified that the trust was set up for estate planning and retirement security purposes.[111] The debtor refused to acknowledge that shielding his assets from his

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102. *See id.*
103. Lawrence v. Goldberg (*In re* Lawrence), 227 B.R. 907, 917-18 (Bankr. S.D. Fla. 1998).
104. *See id.* at 918.
105. *See id.* at 911.
106. *See id.*
107. *See id.*
108. *See id.* at 911-12.
109. *See id.* at 912.
110. *See id.*
111. *See id.*

creditors was an important aspect of the arrangement.[112] The court found this testimony to be "absurd, given the fact that absent this shielding effort, there would be no money left for his retirement as creditors would have taken every penny they could find."[113] The debtor testified that the pendency of the arbitration with Bear, Stearns played no role in his decision to transfer assets to the trust.[114] The court again had a hard time accepting the debtor's testimony:

> Whether one characterizes the motive as "retirement security" or not, placing assets this far from the reach of creditors inherently evidences a singular intention. The purpose of the trust was clearly to shield the Debtor's assets from a creditor which the Debtor feared was about to obtain a staggering $20 Million arbitration award against him. The timing of the trust's creation is further evidence of this intent.[115]

As a discovery sanction, the court ordered that the facts alleged in the trustee's complaint, including those regarding the debtor's interest in the Mauritian trust, were deemed to be established.[116] The court also stated that it believed that the debtor had perjured himself during the evidentiary hearing and that it intended to make a reference to the United States Attorney for further investigation in connection with this finding.[117]

VII. CONCLUSION

The *Portnoy, Brooks,* and *Lawrence* cases demonstrate that under the right facts and circumstances, courts can and will enter orders finding spendthrift provisions of asset protection trusts invalid. These cases and this Article discuss a path that a bankruptcy court may follow to find that property transferred to an asset protection trust is property of a bankruptcy estate. Such a finding may lead to effective remedies for creditors, such as denial of a discharge to a debtor, orders compelling a debtor to direct a trust trustee to transfer assets, with contempt orders if the debtor fails to comply, and, possibly, a claim against a professional who assisted a debtor in setting up the asset protection trust. In cases involving domestic trusts, because the bankruptcy court will have personal jurisdiction over the trustee, any judgment entered by a bankruptcy court would be binding on

112. *See id.*
113. *Id.*
114. *See id.* at 914.
115. *Id.*
116. *See id.* at 917.
117. *See id.* at 918.

the trustee and a bankruptcy trustee or a creditor should be able to pursue remedies against the trust trustee. In cases involving offshore trusts, such as *In re Brooks* and the Hess article mentioned at the beginning of this paper, where an asset such as stock of a domestic corporation is at issue, a court may be able to order the cancellation of stock transferred to a trust and the issuance of stock to a creditor or a bankruptcy trustee. However, unless and until governments take legislative action to prevent transfer of assets to asset protection trusts, creditors will not have completely effective remedies against a debtor who transfers assets to an offshore asset protection trust.

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