2002 Summer Seminar

Bankruptcy Update

10:15—11:00 a.m.

Materials prepared by:
Eric W. Lam
Third Floor, Comm. Exchange Bldg.
PO Box 1943
Cedar Rapids, IA 52406-1943
319-366-7331
Fax: 319-366-3668

Friday,
August 9, 2002

BANKRUPTCY UPDATE

Eric W. Lam
June 2002

OFF-SHORE TRUSTS

Several "asset-planners" advocate establishment of "off-shore trusts" to shield assets from creditors. Caselaw may, however, be signaling a judicial trend *against* the efficacy and enforceability of such arrangements. *Lawrence v. Goldberg (In re Lawrence)*, No. 00-14481, 2002 WL 86680 (11th Cir. Jan. 23, 2002) and *Federal Trade Comm'n v. Affordable Media*, 179 F.3d 1228 (9th Cir. 1999) are two recent examples. In each case, the issue on appeal was whether the district court erred in finding the trust settlors in contempt for failing to comply with an order to turnover the trust corpus.

***Federal Trade Comm'n v. Affordable Media*, 179 F.3d 1228 (9th Cir. 1999).** In *Affordable Media*, the Andersons created a trust under the law of the Cook Islands in an effort to protect their assets from liabilities. *See id.* at 1232. The trust named the Andersons as co-trustees together with a foreign company licensed to conduct trustee services under Cook Islands law. *See id.* Additionally, the Andersons were named the trust's protectors. *See id. at 1242.* The trust contained so-called duress provisions, which provided that upon the occurrence of an event of duress, the Andersons would be terminated as co-trustees and, accordingly, "control over the trust assets would appear to be exclusively in the hands of the foreign trustee." *Id.* at 1240. An event of duress was defined under the trust to include the issuance of any court order or judgment, which in the opinion of the protector would expropriate, sequester, or in any way restrict the free disposal by the trustee of the trust assets. *Id.*

Subsequently, the Federal Trade Commission brought a claim against the Andersons, and

a temporary restraining order and preliminary injunction were entered ordering the Andersons to repatriate any assets held for their benefit outside the United States. *See id.* at 1232. In response to the injunction, the Andersons sent the foreign trustee a letter instructing the trustee to repatriate the trust assets to the United States to be held in the control of the court. *See id.* Upon receipt of the letter, the foreign trustee notified the Andersons that the TRO was an event of duress under the trust, removed the Andersons as co-trustees in accordance with the trust's duress provisions, and refused to repatriate the assets. *See id.* The FTC moved to find the Andersons in civil contempt for failure to comply with the TRO, and the Andersons responded that it was impossible for them to comply with the TRO because they no long had control over the trust. *See id.* The district court rejected the Andersons' impossibility of performance theory and found them in civil contempt. *See id.* at 1241. In finding the Andersons in civil contempt, the district court specifically found that they were still in control of the trust. *See id.* at 1241.

The Ninth Circuit Court of Appeals affirmed and ruled that the district court was not clearly erroneous in finding the Anderson still retained control over the assets. *See id.* at 1243. The court of appeals noted that "[a] party's inability to comply with a judicial order constitutes a defense to a charge of civil contempt." *Id.* at 1239 (citing *United States v. Rylander*, 460 U.S. 752, 757, 103 S.Ct. 1548, 75 L.Ed.2d 521 (1983). The court further noted, however,

> It is readily apparent that the Andersons' inability to comply with the district court's repatriation order is the intended result of their own conduct – their inability to comply and the foreign trustee's refusal to comply appears to be the precise goal of the Andersons' trust.
>
> ...
>
> Given that these offshore trusts operate by means of frustrating domestic courts' jurisdiction, we are unsure that we would find that the Andersons' inability to comply with the district court's order is a defense to a civil contempt charge. We leave for another day the resolution of this more difficult question

> because we find that the Andersons have not satisfied their burden of proving that compliance with the district court's repatriation order was impossible.
> ...
>
> In the asset protection trust context, moreover, the burden on the party asserting an impossibility defense will be particularly high because of the likelihood that any attempted compliance with the court's orders will be merely a charade rather than a good faith effort to comply. Foreign trusts are often designed to assist the settlor in avoiding being held in contempt of a domestic court while only feigning compliance with the court's orders.

Id. at 1239-41. The court of appeals based its ruling on the district court's finding that (1) the Andersons were still protectors of the trust, (2) the trust provided that the duress provisions were subject to the protectors' powers, and the protectors could appoint new trustees, and (3) the Andersons attempted to resign as protectors once the existence of the trust was revealed to the court. *See id.* at 1242-43. "Given that the Andersons' trust is operating precisely as they intended, we are not overly sympathetic to their claims and would be hesitant to overly-restrict the district court's discretion, and thus legitimize what the Andersons have done.

***Lawrence v. Goldberg*, No. 00-14481, 2002 WL 86680 (11th Cir. 2002 Jan. 23, 2002).**

Lawrence presents a fact pattern similar to *Affordable Media*. Lawrence settled an offshore trust, which granted him the sole power to appoint trustees. *Lawrence*, 2002 WL 86680, *1. Two months later, a judgment was entered against Lawrence. *Id.* Lawrence amended the trust several times; these amendments included (1) adding a spendthrift provision, (2) adding a duress clause that prohibited Lawrence from exercising his powers under duress, and (3) irrevocably proscribing Lawrence from ever being a beneficiary under the trust. *Id.* Subsequently, Lawrence filed a voluntary bankruptcy petition, and the bankruptcy court entered an order directing Lawrence to turnover the trust assets. *Id.* Lawrence argued that it was impossible for him to comply with the order, but the bankruptcy court rejected the impossibility defense and found that

Lawrence had *de facto* control over the trust through his retained powers to remove and appoint trustees and to add and exclude beneficiaries. *Id.* Consequently, the court found Lawrence in contempt. *Lawrence*, 2002 WL 86680, *1. Thereafter, Lawrence executed a document naming the bankruptcy trustee as the trust's trustee and advising the previous trustee of his action; Lawrence asserted that he had no further power to turn the assets over to the bankruptcy trustee. *Id.* The bankruptcy court's order was appealed first to the district court, which affirmed the order.

The Eleventh Circuit Court of Appeals then affirmed the district court. The court of appeals agreed that Lawrence's powers to appoint trustees and name beneficiaries meant that Lawrence retained *de facto* control over the trust. *Id.* at *3. Further, the court of appeals stated,

> [W]e must agree with the trial court that Lawrence's claimed defense is invalid because the asserted impossibility was self-created. We previously have held that, "where the person charged with contempt is responsible for the inability to comply, impossibility is not a defense to the contempt proceedings." ... We agree with the district court that Lawrence created this trust in an obvious attempt to shelter his funds from an expected adverse arbitration award.

Id. at *4 (quoting *Pesaplastic, C.A. v. Cincinnati Milacron Co.*, 799 F.2d 1510, 1521 (11th Cir. 1986)).

Recent Decisions from the Eighth Circuit

The following is a partial listing of some of the bankruptcy-related opinions issued by the Eighth Circuit during the previous six months.

Siemer v. Nangle (In re Nangle), 274 F.3d 481 (8th Cir. 2001). Pre-petition state court judgment established §523(a)(6) elements.

Stoebner v. Wick (In re Wick), 276 F.3d 412 (8th Cir. 2002). Chapter 7

trustee, who did not object to debtor's exemption claim to stock options valued as "unknown," nonetheless entitled to portion of options that related to the four-month period before petition filing. *Cf. In re Soost*, 262 B.R. 68 (8th Cir. Bankr. App. 2001) (debtor claimed $1 exemption in home may only avoid lien to the extent of $1).

Owens v. Miller (In re Miller), 276 F.3d 424 (8th Cir. 2002). Bankruptcy court erred by imputing broker's fraud to debtors by way of the "control person" provisions of the Securities Exchange Act. *Cf. Deodati v. M.M. Winkler & Associates*, 239 F.3d 746 (5th Cir. 2001) (debt that arose from fraud of innocent partners' associate non-dischargeable under §523(a)(2)(A), regardless of whether innocent partners benefitted from fraud).

Drewes v. Vote (In re Vote), 276 F.3d 1024 (8th Cir. 2002). Debtor, not Chapter 7 bankruptcy estate, entitled to benefits under Market Loss Assistance Payment Program and Crop Disaster Program, which were enacted by Congress post-petition).

DuBois v. Ford Motor Credit Co., 276 F.3d 1019 (8th Cir. 2002). Debtor, who continued to make lease payments post-discharge, desired a new lease on a new vehicle; Ford conditioned the new lease on the debtor's payment in full of the old lease; CA8 held no §524 violation. *Cf. In re Jamo*, 283 F.3d 392 (1st Cir. 2002) (no §362 violation when creditor "linked" reaffirmation of secured debt to unsecured debt)

Brown v. Luker (In re Zepecki), 277 F.2d 1041 (8th Cir. 2002). Attorney's pre-petition services relating to sale of property were "in connection with or in

contemplation of" bankruptcy, within the meaning of §329; court possessed jurisdiction to examine and order disgorgement of such fees.

Parsons v. Union Planters Bank (In re Parsons), 280 F.3d 1185 (8th Cir. 2002). Debtor's commissions resulting from pre-petition listing agreements were property of estate.

Meeks v. Red River Entertainment of Shreveport (In re Armstrong), 285 F.3d 1092 (8th Cir. 2002). Casino did not sustain its burden to prove §548(c) "good faith," when casino extended credit to debtor; *see also Brown v. Third National Bank (In re Sherman)*, 67 F.3d 1348 (8th Cir. 1995).