

Fraudulent Transfer Developments

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If someone sues and gets a money judgment against you, the court authorizes the plaintiff to collect from your assets. In the absence of a fraudulent transfer (an attempt to hide the assets and lie about it), however, that does not translate into a requirement that you make it easy for the creditor. Constitutional safeguards are afforded debtors for enforcement of judgments. Within that framework, defensive planning is often possible.

One of the more troublesome is the creditor's remedy when assets are transferred beyond the jurisdiction of the court, such as a tax haven trust. By definition, the transfer was lacking in consideration, thus potentially voidable as a fraudulent transfer. Case law offers some relief as to a claim of *actual* fraud (as opposed to constructive fraud). For example, if you had a legitimate reason for the transfer, fraud will not be inferred. In most cases, this legitimate reason would be a desire to establish a tax-efficient multi-generational trust that works best in a no-tax jurisdiction. That reasoning, however, does not protect against a *constructive* fraud claim. Actual fraud is a transfer made with intent to hinder, defraud, or delay a particular creditor. Constructive fraud is the same transfer – irrespective of intent – made either while insolvent or which rendered the debtor insolvent.

Where testamentary intent is the predicate for moving funds offshore, protection is still needed for the risk that the transfer is found to be constructively fraudulent. The most common tactic is to include a *duress* clause in the trust, along the following lines:

" 10. **Duress.** Notwithstanding any provision herein to the contrary, if Trustee perceives that Settlor provides any direction under duress from any source, Trustee may follow such direction, or refuse to follow it, or take any other action with respect to it or the Trust Estate, which it, in its sole and absolute discretion, believes to be in the best interest of Settlor under the circumstances."

The aim here is to provide the debtor with an "impossibility defense" to a claim of fraudulent transfer. Here is how it works. If a transfer is found to be fraudulent, the court may cancel the transfer. (The term is "avoid.") Upon doing so, the court will order the debtor to bring back the money or other property so as to make it available to the creditor. (The term is "repatriate.") This mandatory injunction is quasi-criminal in nature, meaning you may be jailed for failure to comply. (The term is "contempt of court.")

The required elements for enforcing a contempt of court citation are (a) a lawful court order, (b) known to the contemnor, (c) wilfully violated. There is rarely a question about the lawfulness of the order, or the knowledge of the debtor, but the question of wilfulness turns on the court's view of the duress clause.

Picture it: you lose the big case and end up with a multi-million-dollar judgment against you; you mortgage the house and transfer the proceeds and all your savings to a trust in Grand Cayman; the judgment creditor serves you with a subpoena for an oral examination of judgment debtor where your tactic is revealed; the creditor commences an action for fraudulent transfer; at the end, the judge turns to you and says, “The transfer is hereby avoided. You are ordered to repatriate the funds back into this county. Come back here in 30 days to report, and if you have not complied, bring your toothbrush because you are going to jail. You nod your head, leave the courtroom, pull out your cell phone, and call the trustee. You explain the event, send a confirming letter, and shortly before the next hearing, you receive a letter from the trustee reporting that it cannot comply with the repatriation instruction because it was given under duress (the court’s threat of incarceration). You appear at the hearing, the judge asks if you complied, you reply that you tried but was unable to persuade the trustee to send back the money. The judge sternly responds, “You goin’ to jail, girl,” at which time you recite the required elements noted above and reply: “I don’t question the legality of the order for repatriation, and I was aware of it at all times relevant, but it is impossible for me to comply with the order because the trustee refuses to return the money.”

Based on the law, that is a good defense. Our Ninth Circuit Court of Appeals has created fact-specific exceptions that make it problematical for Ponzi operators and bankruptcy fraudsters, among others, but the rule remains. Last year, we saw an affirmation of the rule in *U.S. vs Grant*.

Facts. Mr. and Mrs. Grant moved money in unspecified amounts to two trusts, one in Bermuda and one in Jersey (Channel Islands), all while owing some \$36 million in income taxes. Suit was brought by IRS, and an order for repatriation was made by the U.S. District Court in Miami. Along the way, Mr. Grant died. Upon discovering the trust transfers, IRS moved for a contempt order against Mrs. Grant.

Rule. The court may not order the incarceration of Mrs. Grant if she found compliance with the order to be impossible.

Discussion. Courts have the inherent power to enforce their orders through civil contempt. A party seeking civil contempt “bears the initial burden of proving by clear and convincing evidence that the alleged contemnor has violated an outstanding court order.” (*Commodity Futures Trading Commission vs Wellington Precious Metals, Inc.*, 950 F.2d 1525, 1529 (11th Cir. 1992) After proving a violation, the burden of going forward with the evidence shifts to the alleged contemnor, “who may defend his failure on the grounds that he was unable to comply.” (*Commodity Futures Trading Commission, ibid; U.S. vs Rylander*, 460 U.S. 752, 757, (1983) The court in *Rylander* expressed the rule this way: “Where compliance with a court order is impossible, neither the moving party nor the court has any reason to proceed with the civil contempt action.”

Mrs. Grant wrote to each offshore trustee requesting repatriation, and was rebuffed based on the duress clause. She then contacted several U.S. corporate fiduciaries to ask them to serve as transferee trustees. All of them refused, in part because they expected to meet determined resistance from the offshore trustees.

Conclusion. More than two years passed after the repatriation order was issued, with not a dime repatriated. The court found that this failure was not for lack of effort. Mrs. Grant did her best, but her efforts simply proved fruitless. The court went on to find the impossibility defense adequately established, and denied the motion for a contempt order.

How Mrs. Grant might access the funds notwithstanding the outstanding judgment is beyond the scope of this article. The genius of man, however, knows no human limits as to ways and means.