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**ASSET PROTECTION
AN INTRODUCTION TO MORALS, ETHICS,
GOALS AND METHODOLOGY**

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– RISK MANAGEMENT –

The term “asset protection” embodies a somewhat amorphous concept broadly understood as planning that is meant to protect the client from the claims of creditors. Yet, there is no substantive body of law called “asset protection.”¹ The term instead connotes a practice area encompassing *inter alia* debtor-creditor law, contract and commercial law, bankruptcy law and practice, the law of trusts & estates, conflicts of laws, civil procedure, judgments & remedies, etc.

But at its core, asset protection is really part and parcel of the larger non-legal concept of “risk management.” Risk management is planning that seeks to protect the client from any potential future losses. Risk management encompasses a wide variety of activity, from studying business practices to eliminate the potential for employee injuries, to financial risk management that seeks to prevent losses due to market fluctuations.

Within the larger concept of “risk management” is the subset of “legal risk management.” This is planning that seeks to protect the client from legal problems, meaning to prepare for and deter future legal problems, and to terminate existing legal problems in a timely and efficient fashion.

Indeed, the concept of “asset protection” transcends the strict construction of the term, of simply protecting particular assets. Instead, asset protection is really pre-litigation planning that is meant to assist the client in completely ridding herself of any litigation that could arise.

It is in this expansive context that “asset protection” will be discussed, and not the more restrictive context of merely protecting assets without consideration of the other goals of the client, such as ridding herself of litigation so that she may get on with her business.

– ISSUES OF MORALITY IN ASSET PROTECTION –

This section considers the morality of asset protection. Considerations include whether asset protection planning should even exist, and if so in what circumstances is asset protection planning appropriate.

In modern society, morality is something that is intensely personal and thus by and large is left to the individual -- except in cases where others may be harmed. An example is alcohol. As an adult, you are free to drink alcohol. However, drunk driving is harmful to others; therefore, you are not allowed to drink and drive.

Questions arise in asset protection planning as to whether the planning "harms" someone else; namely, creditors. Questions also arise as to timing, *i.e.*, if you engage in asset protection planning when you don't have any claims against you, are you at that time harming yet-unknown future creditors?

Various bodies of law, including those codified in the Uniform Fraudulent Transfers Act, attempt to define when asset protection is proper and when it is not. Yet, as with almost every area of law, the boundaries between proper and impermissible are rarely clear.

Does the legal boundary of permissible asset protection affect its morality? In other words, is the conduct any more or less morally defensible because it is allowed? Or, to take the flip side, if something is not allowed does that always mean that it is wrong for the debtor to take that course?

The hardest questions of morality seem to be in distinguishing those cases where asset protection is appropriate from those where it is not. While this seems purely philosophical and abstract in nature, the resolution of such questions can often have stunningly practical effects. The moral implications of creating a particular asset protection plan for a particular circumstance may determine whether or not the plan ultimately works.

Keep in mind that a judge may be influenced by moral considerations when determining whether to allow a particular asset protection structure to protect assets from a particular creditor. Similarly, a jury evaluating a possible obstruction of justice claim, or a civil lawsuit for civil conspiracy to defraud creditors, will likely make their own moral judgments. This means we must heed, in the vernacular of trial lawyers, "the cornfield equities".

Questions of morality thus play a very real and very practical role in asset protection planning. This fact has largely been overlooked in the professional journals and elsewhere -- the question of *how* to protect particular assets greatly overshadows the larger and more important question of whether those assets should even be protected in the first place. Yet, the considerations are inseparable. A good asset protection plan is likely to fail if the client is in the wrong, just as a bad asset protection plan is more likely to succeed if the client is in the right.

I have created the following scenarios to illustrate the moral issues involved in asset protection planning. Reading through these scenarios may elicit a gut reaction of sympathy or antipathy similar to the feelings a judge or jury may have toward the debtor, and by association debtor's planner.

Adkisson's Scenario No. 1 -- The Businessman and the Bank

Basic Facts: Businessman takes a loan from the Bank for the express purpose of making widgets. The Bank makes the Businessman personally guarantee the loan. In which cases below (if any) should the Businessman be able to protect his assets from the Bank, and to what extent?

1. Businessman doesn't spend the money on widgets, but purchases a new yacht.
2. Businessman intends to pay the Bank back, but instead of investing in manufacturing equipment uses the money to engage in speculation in the commodities market. The Businessman's speculation fails and he cannot repay the loan.
3. Businessman makes widgets as planned, but there is an unexpected decline in the demand for widgets and the business fails.
4. Prior to giving the loan, the Bank gives assurances to the Businessman that if the Businessman needs more money to succeed, the Bank will extend additional loans to the Businessman. Relying on this, the Businessman takes the loans. Later, at a critical point for the new business, the Businessman requests that the Bank extend the additional loans as the Bank had earlier assured it would do. The Bank fails to extend the loans, and the business fails.

5. The Bank decides that the business is valuable, so it causes a short term decline in the price of widgets, thus causing the business to fail. Bank takes over the business and sues the Businessman on the loan.

Adkisson's Scenario No. 2 -- The Stockbroker and the Investor

Basic Facts: The Stockbroker persuades Investor to invest, but the investment doesn't turn out as Investor desired and Investor sues Stockbroker.

In which of the following cases (if any) should the Stockbroker be able to protect his assets from the Investor, and to what extent?

1. Stockbroker creates a "pyramid scheme" without economic substance, where all returns of existing investors are paid solely from the principal of new investors who are brought in. Stockbroker tells Investor that the pyramid scheme is a real deal, but Investor loses everything when the scheme collapses.
2. Stockbroker persuades Investor to invest in a penny stock. Stockbroker knows company has no real operations, but Stockbroker gets sufficient new buyers into the stock to pump the price up. After the price goes up, Stockbroker dumps his own stock, netting a huge profit. However, this selling drives the price of the stock back down, and everyone whom Stockbroker put into the stock, including Investor, suffers huge losses.
3. Stockbroker, in good faith, analyzes the value of Widget Co. to be worth \$100 per share. Widget Co. is presently trading at \$50 per share. Stockbroker moves all of his clients, including Investor, into Widget Co., but through no fault of the Stockbroker Widget Co. stock falls from \$50 per share to \$10 per share. Investor loses 80% of his investment in Widget Co.
4. Stockbroker, in good faith, analyzes the value of Widget Co. to be worth \$100 per share. Widget Co is presently trading at \$50 per share. Stockbroker moves all of his clients, including Investor, into Widget Co., but the stock only goes to \$98. Even though Investor has made a nice profit, he sues Stockbroker for the unrealized \$2 per share.
5. Same facts as No. 4, above, except that Investor has a reputation for being a "career plaintiff" and has been a plaintiff in no less than 18 similar lawsuits.

Adkisson's Scenario No. 3 -- The Taxpayer and the IRS

Basic Facts: The Taxpayer hasn't paid his taxes, and the Internal Revenue Service is attempting to collect. In which of the following cases (if any) should the Taxpayer be able to protect his assets from the Internal Revenue Service, and to what extent?

1. Taxpayer engages in blatant tax evasion.
2. Taxpayer attempts very aggressive tax strategy, based on a Big 5 opinion letter, but the tax court rules against him.
3. Taxpayer attempts conservative tax strategy, but his CPA (who has no assets or insurance) messes up the strategy, creating a huge unpaid tax liability.
4. Taxpayer pays all personal taxes, but gets into a dispute over unpaid business taxes. The IRS agent is overly aggressive, and seeks to freeze Taxpayer's personal assets to put pressure on him to settle the dispute over the business taxes.
5. Taxpayer pays all personal taxes, but unbeknownst to Taxpayer his business partner has failed to remit payroll taxes. The partnership later fails, and both the taxpayer's partner and the partnership file for bankruptcy. The IRS seeks the unpaid payroll taxes from Taxpayer.

Adkisson's Scenario No. 4 -- Husband and Wife

Basic Facts: Husband and Wife get a divorce, and Wife seeks assets and alimony. In which of the following cases (if any) should Husband be able to protect his assets and income from his ex-Wife?

1. Husband and Wife are married in Las Vegas three days after meeting in a bar. Over a year later, Wife files for divorce and seeks 1/2 of the Husband's assets.
2. Husband and Wife are married in Las Vegas three days after meeting in a bar. They live happily together for 10 years. Husband runs off with his secretary who is half his age. Wife seeks 1/2 of the Husband's assets.

3. Husband and Wife are married in college. They struggle through school together. Soon after leaving college, Husband forms a Company. Husband files for divorce days before the Company's stock goes public. Wife seeks a large percentage of the Company's stock.
4. Same scenario as No. 3, above, except that Wife also worked part-time to put Husband through college, and after college worked as an unpaid employee for the Company.

Adkisson's Scenario No. 5 -- Child Support

Basic Facts: Father and Mother marry, and have a child. Later, they divorce and Mother seeks child-support payments from Father. In which of the following cases (if any) should Father be able to protect his assets and income from the child-support order?

1. Father has the ability to repay the child-support, but is a “deadbeat dad” who welches on his obligations to other creditors as well.
2. Father has the ability to repay the child-support and has funded a trust for the children’s education and well-being, but Mother comes from a wealthy family and is pursuing the child-support only for spite.
3. Mother tells Father that the child is his to induce Father to marry. After birth of the child, it becomes apparent that Father is really not Father, and a blood test confirms this. However, the laws of the state wherein they were married say that Father has to pay child-support anyway.
4. Father and Mother divorce before Mother even tells Father of pregnancy. Child shows up on Father's doorstep 17 years later and demands back child support.

Adkisson's Scenario No. 6 -- The Icy Highway

Basic Facts: Driver is navigating icy highway, and slides into Victim. In which of the following cases (if any) should Driver be able to protect his assets and income from the Victim?

1. Driver is intoxicated.
2. Driver is sober, but reckless.

3. Driver is a surgeon who was attempting to rush to the local hospital to perform life-saving surgery, but hit a patch of hard-to-detect "black ice" and slid into a school bus.
4. Victim is a "career plaintiff" who has filed 12 similar lawsuits, and in this case cut in front of Driver so that Driver couldn't help but hit Victim.
5. Crash is not so severe that a normal person would have been hurt, but Victim in this case has rare spinal condition and the wreck results in the Victim losing all bodily motion.

-- ISSUES OF ETHICS IN ASSET PROTECTION --

This section considers some of the *technical* ethical problems faced by U.S. attorneys who are involved in asset protection planning. This section does not consider questions of morality in asset protection planning, nor a planner's personal ethics. Our examination here is solely and exclusively on whether particular conduct may or may not violate the American Bar Association's Model Rules of Professional Conduct or equivalent state professional conduct rules, and result in professional discipline of the attorney.

The ethical questions of asset protection planning -- like the larger moral questions of asset protection planning -- have been poorly addressed, if at all, by the asset protection bar. Far too many planners have simply read some materials on creating offshore trusts and family limited partnerships, and then "leapt into the deep end" of asset protection planning. Many have taken this leap to increase their practice revenues without performing even a cursory analysis of whether their planning is appropriate or defensible generally, or in the context of the particular cases they are working.

This discussion is not meant to, and does not, consider whether the attorney may be liable to the client or to other persons, such as creditors, as a result of violating these rules. As stated in the Preamble to the Model Rules, the "[v]iolation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached."

The Model Rules are written in very general terms and provide only vague guidance through the toughest issues faced by attorneys who practice in the area

of asset protection. Thus, the Model Rules cannot and should not be relied upon as the only benchmark of whether an attorney's conduct is proper. This is reflected in the Preamble to the Model Rules:

The Rules presuppose a larger legal context shaping the lawyer's role. That context includes court rules and statutes relating to matters of licensure, laws defining specific obligations of lawyers and substantive and procedural law in general. Compliance with the Rules, as with all law in an open society, depends primarily upon understanding and voluntary compliance, secondarily upon reinforcement by peer and public opinion, and finally, when necessary, upon enforcement through disciplinary proceedings. The Rules do not, however, exhaust the moral and ethical considerations that should inform a lawyer, for no worthwhile human activity can be completely defined by legal rules. The Rules simply provide a framework for the ethical practice of law.

-- Preamble to Model Rules of Professional Conduct

“Frustrate and Impede”

Applying The Model Rules of Professional Conduct to assets protection practice presents some unresolved ethical questions. The questions discussed below focus on the impact of an asset protection lawyer's conduct on creditors or on the courts. This discussion focuses in part on the Ninth Circuit's finding in the Anderson case (*FTC v. Affordable Media LLC*, 179 F. 3d 1228 (9th Cir. 1999) ("*Anderson*")) that the Andersons asset protection plan was "designed to frustrate and impede" the courts of the United States.

Model Rules of Professional Conduct Rule 1.2 -- *Scope of Representation*

- (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . .

Unresolved Questions:

1. Will an asset protection structure “designed to frustrate and impede” courts be considered “obstruction of justice” and thus “criminal” for purposes of Rule 1.2?

2. Will a structure designed to render unenforceable state or federal fraudulent conveyance laws be considered fraudulent for purposes of Rule 1.2?

Model Rules of Professional Conduct Rule 1.16 -- *Declining or Terminating Representation*

- (a) Except as stated in paragraph (c) [court orders lawyer to continue representation], a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:
 - (1) the representation will result in violation of the rules of professional conduct or other law . . .

Unresolved Questions:

1. Does the creation of a structure that is meant to “frustrate and impede” the courts violate “other law”?
2. Can an attorney accept the representation if he or she knows that the structure might in the future be used to perpetrate a fraud on creditors?
3. Can an attorney accept the representation if he or she knows that the structure may be used to commit a crime (obstruction of justice)?

Model Rules of Professional Conduct Rule 4.4 -- *Respect for Rights of Third Persons*

In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person . . .

Unresolved Question:

1. Are the use of structures which are meant to “frustrate and impede” the courts, and thus thwart or delay creditors “means that have no substantial purpose other than to . . . delay . . . a third person”?

“Feigning Compliance”

Portions of the Ninth Circuit's *Anderson* opinion focuses on whether the Anderson's trust, and asset protection trusts in general, are designed to aid a debtor's effort to mislead a court. The court stated: “In the asset protection trust context . . . 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.” *FTC v. Affordable Media LLC*, 179 F. 3d 1228 (9th Cir. 1999) (“*Anderson*”).

Model Rules of Professional Conduct Rule 3.3 -- *Candor toward the Tribunal*

- (a) A lawyer shall not knowingly:
 - (1) make a false statement of material fact or law to a tribunal;
 - (2) fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client;
- * * *
- (4) offer evidence that the lawyer knows to be false. If a lawyer has offered material evidence and comes to know falsity, the lawyer shall take appropriate remedial measures.
- (b) The duties stated in paragraph (a) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6 [*i.e.*, by attorney-client privilege].

Unanswered Questions:

1. Does a structure which has as its effect a “charade” on the court, or is designed with the effect of “feigning compliance” with a court’s orders, the giving of false evidence to the court?
2. Does the attorney have any later duty to advise the Court that the client has *de facto* control over assets, if the client testifies that there is no control?

Counseling a client to use a foreign asset protection trust may violate the Model Rules of Professional Conduct quoted above. This violation may arguably occur even where the attorney has no knowledge of any fraud or intent to defraud on the part of the client. On the other hand, advising a client to use asset protection trust arguably constitutes no violation of these rules, and instead merely allows the client to take advantage of favorable laws duly enacted in jurisdictions unfavorable to creditors.

Attorney Disciplinary Proceedings

Issues relevant to asset protection planning have been the subject of numerous attorney disciplinary proceedings in various jurisdictions. An excellent example is *In re Kenyon and Lusk*, 327 S.C. 307, 491 S.E.2d 252 (1997), wherein an attorney who counseled a client in connection with a conveyance of property designed to frustrate creditors was suspended for 15 months:

[A]cts sufficient to constitute the civil definition of fraudulent conveyances do not have to be found for us to find misconduct. We do not have to find fraudulent conveyances – only fraudulent or dishonest conduct. In *In re Hockett*, 303 Ore. 150, 734 P.2d 877 (1987), an attorney disciplinary proceeding involving an attorney who assisted his client in transferring assets to avoid creditors, the court found no tortious fraudulent conveyances. However, the court specifically found that “assisting clients to cheat creditors is ‘dishonesty’ under DR 1-102(A)(4)”. <FN3> We find respondents committed misconduct in conveying this property.

<FN3>. Other jurisdictions have also addressed situations involving similar misconduct and fraudulent conveyances. *Florida Bar v. Scott*, 566 So.2d 765 (Fla. 1990) (attorney who concealed property for a friend to avoid creditors committed misconduct); *In the Matter of Breen*, 113 N.J. 522, 552 A.2d 105 (1989) (attorney who fraudulently prepared four mortgages against his residence and transferred title to a friend to defraud creditors was disbarred); *In the Matter of De Pamphilis*, 30 N.J. 470, 153 A.2d 680 (1959) (attorney received public reprimand for recommending transfers to defraud creditors); *In re Hockett*, supra (attorney who handled divorce proceeding so as to preclude creditors of husband from obtaining assets through fraudulent conveyances was suspended).

Potential Liability of Planner to Creditors

Even if the planner is able to navigate the foregoing ethical morass, this does not *ipso facto* mean that the planner cannot become independently liable (or jointly liable with the debtor) to the creditor for the planning that is done. The reason for this is that there is a substantial independence between the ethical rules and the theories of civil liability upon which the planner may be hooked. The Model Rules of Professional Conduct itself expressly disclaims the creation of liability for violation of one or more of its ethical rules,² – but this is a two-edged sword that also may mean that full compliance with the Model Rules will not be a shield against potential liability to a creditor (or to the client if additional liability from the client to the creditor is negligently created)

A theory based on negligence might be difficult to assert, because the asset protection planner typically owes no duty to the creditor. Civil conspiracy is a more appealing theory, and has the potential to make the planner essentially jointly liable with his debtor client for portion of the judgment which was defeated by the asset protection plan. *See, e.g., Peacock v. Thomas*, 516 U.S. 349, 116 S.Ct., 862, 133 L.Ed.2d 871 (1996) (civil conspiracy theory asserted by thwarted creditor though case dismissed for lack of ancillary jurisdiction); *North Texas Production Credit Ass'n v. McCurtain County Nat'l Bank*, 222 F.3d 800, 42 U.C.C.Rep.Serv.2d 888 (10th Cir. 2000) (creditor could assert civil conspiracy claim against debtor and others); *Morganroth & Morganroth v. DeLorean*, 213 F.3d 1301 (10th Cir. 2000) (debtors could be liable for civil conspiracy for transactions with third-parties to defeat creditors); *Thomas v. Barton Lodge II, Ltd.*, 174 F.3d 636 (5th Cir. 1999) (creditor's civil conspiracy theory recognized; but statute of limitations had run); *DeMauro v. DeMauro*, 115 F.3d 94 (1st Cir. 1997) (spouse included civil conspiracy claim along with civil RICO claim against husband who 'by means of false pretenses, representations, and devices established bank and investment accounts in Switzerland, [the] Middle East, France, Liechtenstein, several states of the United States and various and sundry other locations most of which accounts were established under the names of straws, sham trusts, shell companies and phony 'foundations,' all designed to conceal the location, extent, and existence of assets from [wife] and persons with whom [husband] did business.'").

In *Monastra v. Konica Business Machines, U.S.A., Inc.*, 43 Cal.App.4th 1628, 51 Cal.Rptr.2d 528, 29 U.C.C.Rep.Serv.2d 1306 (1996), the California Court of Appeals held that a civil conspiracy theory could be asserted on an underlying fraudulent transfer:

Monastra has also set forth evidence which establishes triable factual issues as to his cause of action for conspiracy. The elements of civil conspiracy are the formation and operation of the conspiracy and damage resulting to the plaintiff. (*Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal. 4th 503, 511 [28 Cal. Rptr. 2d 475, 869 P.2d 454].) Standing alone, a conspiracy does no harm and engenders no liability; it must be activated by the commission of an actual civil wrong. (*ibid.*) The civil wrong alleged in this case is the fraudulent transfer of Master Technology assets, leaving Master Technology unable to satisfy Monastra's judgment. Monastra has adduced evidence that Konica and Digtect, knowing of Monastra's claim against Master Technology, assisted Gorden in making the transfers and in concealing them from Monastra for as long as possible. From this evidence, a trier of fact could find Konica and Digtect participated in a conspiracy to hinder and delay Monastra in his claims against Master Technology, and were thus jointly liable with Gorden for Monastra's damages.

Id., at 31-32.

In *Karo Marketing Corp. v. Playdrome America*, 752 A.2d 341, 331 N.J. Super. 430 (2000), a New Jersey appellate court held that a civil conspiracy theory could be asserted against debtors who conspired to thwart the creditor even in the absence of a violation of the Uniform Fraudulent Transfer Act. *But see Intervest Capital Group, Ltd. v. Lightfoot*, 1998 Tex. App. Lexis 7328 (civil conspiracy could not be asserted where jury found no underlying fraudulent transfer).

Balancing the Needs of Advocacy

The foregoing section demonstrates two of the larger minefields for asset protection planners, being the threats of professional discipline and becoming additionally liable to creditors. Yet, at the same time the Client is generally owed a duty of diligent representation. Model Rules of Professional Conduct, Rule 1.3. *See also* Code of Professional Responsibility, Canon 7 (regarding the duty of zealous representation). Reconciling these concerns is almost never easy, and sometimes is impossible. Once these considerations have been weighed, close questions may be resolved by reference to the moral issues -- it may be easier to go forward with aggressive Client planning where the Client seems to be in the Right, just as it may be easier to decline representation where the Client has engaged in questionable conduct.

However, once the planner has made a determination to go forward with the representation of a Client, the planner probably owes the Client the duty to go forward without reservation or consideration of the consequences to the planner. It is possible that there is no “middle ground” where the planning is based on a balance of the Client’s needs and the planner’s desire to protect her own position. Indeed, if the planner cannot fully represent the Client’s interest for fear that she herself will be sued, then the planner may have a conflict of interest requiring her withdrawal.

The Special Problem of the “High Visibility” Asset Protection Planner

Certain asset protection planners face a unique problem, being that their presence in a situation may give rise to the inference that a Client has engaged in planning with the goal of defeating creditors. Also, if a planner has written professional articles expounding the virtues of a particular technique for asset protection purposes, these articles may be available for the creditor to use to persuade (read: prejudice) the court against the debtor, by arguing that although the debtor may have voiced certain non-asset reasons for asset protection, that in fact the debtor’s primary intent was to defeat the claims of creditors.

– THE GOALS OF ASSET PROTECTION –

This section considers some of the primary goals in asset protection planning. Certainly, these goals are not exhaustive, and each individual client may have their own additional or varying goals.

GOAL: CLOSURE

The principal goal of asset protection is to create a scenario where a debtor is able to rid herself of the claims of creditors while still retaining a substantial portion of her assets – in other words, a scenario which promotes settlement on terms favorable to the debtor, yet that the creditors are willing to accept as settlement in full of all outstanding liabilities.

The Psychology of Settlement. Reaching a settlement favorable to the debtor may well depend on her creating an image in the minds of her creditors that the settlement being proposed by the debtor is overall the creditors’ best chance of getting the most of the debtor’s assets. Included in the “psychology of settlement” are such factors as the creditors being able to convince a jury of the debtor’s liability and whether the creditors

can also prevail on appeal. Yet another very significant factor is *if* the creditors are able to win a judgment that stands, whether the creditors can collect the judgment against the debtor. The greater the creditors' doubts that they can collect against the debtor, the more favorable the "psychology of settlement" is to the debtor. Thus, a principal goal of asset protection is to create a scenario that plays upon and increases the doubts of the creditors as to whether any judgment they win can be collected.

The Criticality of Settlement. Settlements concluded on the basis of single factors are rare. To the contrary, most settlements are achieved because a large number of circumstances have contemporaneously come together from the viewpoints of both the debtor and the creditor, so that settlement upon the agreed terms make sense for both parties. This convergence of events that finally causes the case to be resolved is known as the "Criticality of Settlement".

A primary purpose of an asset protection plan is to act as a complex lens that brings to the creditor the realization that the judgment will not be collectable, in such a fashion and at the appropriate time so as to encourage settlement. Part and parcel of this function is to impress upon the creditor *prior* to judgment that not only must the creditor gamble in court to obtain the judgment, but that even if the creditor wins the judgment that collection of the judgment will be difficult, if not impossible. Thus, although the asset protection plan is not intended to be effective until after a judgment has been obtained, the truth is that the asset protection plan may perform its greatest service even prior to any such judgment being entered.

Yet, great subtlety must be employed in getting this point across to the creditor. If the asset protection plan is brash and plainly visible, the creditor may be able to somehow introduce the existence of the asset protection plan as proof of the underlying culpability of the debtor, something like "she knew she was wrong, that's why she did the asset protection planning". This is counterproductive, for although the creditor knows and can be concerned about the asset protection plan, at the same time the creditor may believe that the open character of the asset protection plan may increase the creditor's chances of winning at trial and then later persuading the necessary courts to cut through the structure. So, ideally, the asset protection plan should be such that the creditor can figure out that it will be difficult for him to collect on the judgment, yet is not so obvious as to advantage the creditor at trial or in post-judgment collection hearings.

Baiting and Counterattacking Creditors. To increase the prospects of closure, the debtor may seek to draw her creditors into a situation where the creditors have overreached, or otherwise done something which creates liability from the creditors to the debtor. While the creditors may have an offset against this liability, the prospect of costly litigation defending the new claim, in addition to litigation to collect the underlying judgment, militates towards final settlement.

Alternatively, the debtor may look for ways to set up the creditors for liabilities to third parties, including unpaid tax liabilities. While exposing the creditors to these third-party liabilities does not directly benefit the debtor, it may add to the creditors' expense and frustration, thus promoting settlement. It may also help to deter the creditors from aggressively pursuing the debtor's assets.

The goal of these tactics is to re-focus the creditor's attention away from what the creditor thinks he will get in collection, and instead to the creditor's potential added attorney fees and expenses in defending actions wherein the creditor has no chance of positive gain. In litigator's parlance, the creditor should be put into a mindset "where he no longer wants the cheese, but only wants out of the trap".

GOAL: INVIOABILITY OF PERSON

The asset protection plan should seek not only to protect assets, but to protect the person of the Client as well. Threats to the Client include extrajudicial remedies by creditors,³ damage to credit by non-payment of debts or bankruptcy, stigmatization within the business community, etc.

Subtlety. The asset protection aspect of a plan should not be "open and obvious", but rather should be disguised. There are many reasons for this, including that the existence of an asset protection plan (or asset protection purpose) could give rise to the inference – in the minds of the jury or judge – that the Client *knew* she was doing something wrongful, and thus had a reason to protect her assets.

In other words, the existence of an asset protection plan could create the belief that the Client was culpable as to the underlying conduct. This could lead to the perverse result that the Client's asset protection plan would contribute to the issuance of the very judgment against which it is intended to protect. (Conversely, a Client without an asset protection plan

may be able to escape liability against which the Client would have been naked.)

While concepts should as “containment of liability” and the creation of “bankruptcy-remote entities” may make perfectly good business sense, they can carry a negative or perhaps sinister connotation with a lay jury. Thus, the individual components of the asset protection plan should be implemented in independently explainable steps which make economic sense aside from their asset protection purposes, and which can be readily explained to a judge or jury.

Transference. An asset protection plan should be structured so that liability – and more importantly, culpability -- is deflected (or “transferred”) to some third-person. This is typically accomplished by the use of insurance, which shifts the creditors’ pursuit to the insurance policy and away from the Client’s assets, and makes the insurance company the “bad guys” in the eyes of the creditor. But transference can and should be accomplished outside of the insurance context as well. Situations where fault can be transferred to foreign parties not subject to the jurisdiction of U.S. courts, or even to other creditors, should be used to full advantage.

By transferring fault to third-parties, the debtor may also avoid the creditors’ extra-judicial remedies.

Avoid Bankruptcy. The asset protection plan should seek to avoid bankruptcy of any entity involved in the structure. More importantly, the asset protection plan should seek to avoid the personal bankruptcy of the Client. The reasons for this are numerous, and include the fact that bankruptcy courts have some of the strongest powers to set aside, avoid, or ignore the attempts of the debtor to avoid collection. Also, the debtor may subject herself to the possibility of accusations of bankruptcy fraud. *See, e.g., In re Lawrence* 227 B.R. 907 (S.D.Fla. 1998); *Securities and Exchange Commission v. Brennan*, Docket No. 00-6128 (2nd Cir., October 26, 2000) (reversing the District Court's order to compel defendant to repatriate funds; new trial was later scheduled for defendant, who is charged with bankruptcy fraud and money laundering).

GOAL: INVIOABILITY OF ASSETS

Total Coverage. The asset protection plan should provide complete protection for all of the Client’s assets. Exposing any significant assets to creditor may give the creditors’ attorneys the opportunity to “live off the

land” by piecemeal collection attempts leading to the consumption of all of the debtor’s assets. The practice of leaving some property out of the asset protection plan so as to avoid allegations that the debtor has rendered herself insolvent, is not recommended from a tactical standpoint.

Containment. This is often referred to as creating “bankruptcy remote entities”. The basic idea is that if an entity creates a liability, the liability should stay within the entity, and not spread to its owners.

Anytime an entity is used within an asset protection structure, consideration must be given to issues of containment. These considerations must further include whether valuable assets are “contained” within entity within which the liability arose, and are thus endangered by those liabilities. This is sometimes referred to as “never placing non-liability producing assets with liability producing assets”, etc.

Flexibility. Creditors may appear from outside or inside a structure, and may assert claims arising in tort, contract, statute, business law, family law, etc. Rather than attempting to deal absolutely with a standardized hypothetical “plaintiff predator”, it is preferable that an asset protection plan be flexible so that it may change to offer the best defense against the specific creditors that do appear.

Redundancy. Each and every important component of an asset protection feature should be redundant to some extent, and “fail safe” – meaning that no singular act of a creditor will be effective at getting at any of the debtor’s significant assets. Rather, a “defense in depth” strategy should be adopted, and the strategy should be an active structure where additional multiple lines of defense are being created even as a creditor attempts to penetrate the existing ones.

GOAL: COST-EFFECTIVE

To the greatest extent possibly, an asset protection plan should be cost-efficient and should easily fit within the Client’s existing or easily modifiable mode of business operations. Asset protection plans that are costly or cumbersome to administer often go by the wayside, and corporate formalities are disregarded, thus potentially negating the protective features of the plan.

GOAL: DISCRIMINATE

Should an asset protection plan be discriminate? How may an asset protection structure be created which protects the righteous but not the wrongful? An asset protection structure that protects the assets of all persons, no matter how illegal or loathsome their conduct, cannot expect to long survive without changes in the laws to defeat or eradicate such structures. At the same time, do clients want or expect plans which discriminate between their creditors?

– THE METHODOLOGY OF ASSET PROTECTION –

The methodology of asset protection considers the process by which a particular client's asset protection plan is developed and implemented.

TEMPORAL METHODOLOGY

Time Generally. Considerations of time in the asset protection concept have been largely ignored. Yet time may restrict or enlarge the universe of planning opportunities. Indeed, proper timing may greatly enhance a plan, just as inappropriate timing may detract from, and otherwise destroy a plan.

Time as a Restriction on Methodology. Time has a definite and measurable value in the asset protection context. At some future time, a claim may arise against the client. Until that claim arises, the range of available planning alternatives to the client is broad. However, once a claim has materialized, the range of planning alternatives decreases in some proportion to the amount of time remaining until the claim is reduced to judgment, and then more quickly as the creditor begins attempts at collection. The decreasing alternatives available to the debtor as a claim approaches, is liquidated, and then collection attempts are made, is known as the "time decay" of available alternatives.

Timing of Implementation. There is no rule that all aspects of an asset protection plan be implemented at once. Typically, there is strategic merit in implementing particular phases of the asset protection plan at different times so as not to suggest the existence of a "grand scheme", knowledge

of the outlines of which by the creditor may be detrimental to the debtor. Implementation should ideally be at about the same pace at which the Client ordinarily conducts her business, and should blend in with ordinary business decisions.

JURISDICTIONAL METHODOLOGY

Conflict of Laws. At the core of asset protection is the concept that a debtor may avail herself of the laws of a foreign jurisdiction, which laws are more presumably more friendly to the debtor than the laws of her home jurisdiction. In the psychology of settlement, the creditor may have serious questions as to, first, which laws the court will determine will apply and, second, whether under either set of laws the creditor can be successful against the debtor.

Choice of Jurisdiction. There are many aspects to choosing a particular jurisdiction for asset protection purposes. Suffice it to say that the choice of jurisdictions utilized for the asset protection plan should make some sense as measured against the client's existing or reasonably expanded methods of operation. A discussion of particular jurisdictions and their uses is outside the scope of this presentation.

INTEGRATIONAL METHODOLOGY

Integrational Methodology concerns the process by which the asset protection planning is combined with or into other planning conducted for the Client. As mentioned above, one of the goals of an asset protection plan is to be subtle or disguised, which typically means that the asset protection plan should be closely integrated into the Client's other contemporaneous business or estate planning, etc.

STRUCTURAL METHODOLOGY

Structural Methodology considers the various entities or combinations thereof that are utilized to protect the Client's assets. These structures may encompass most if not all of the recognized legal structures traditionally used to insulate or contain liabilities (and perhaps even some new or foreign structures), including without limitation corporations, trusts, and partnerships.

The pros and cons of the typical structures utilized by asset protection planners is left to the other speakers in this presentation.

THE PRODUCTIZATION OF ASSET PROTECTION. A serious problem which has plagued asset protection has been the marketing and implementation of “canned” or “cookie cutter” structures. These structures are advertised as being able to provide substantial protection to virtually anybody who has the asset to protect and are willing to pay the fees for the structure.

The problem with such structures – to the extent they work at all – is that they are indiscriminate, and protect the assets of “bad” people who have committed “bad” acts, as well as they do “good” people. It cannot be expected that the legislatures or the courts will long allow indiscriminate structures. An additional concern is that to the extent that such plans follow any standardized structure, if the standardized structure is penetrated as to any particular structure of its type (even in an egregious case), then precedent may exist for creditors to penetrate any like structures (even in a seemingly favorable case).

DISSOCIATIONAL METHODOLOGY

Introduction to Dissociational Methodology. Dissociation is the distancing of the debtor from her assets without consideration. The story the Dissociative Debtor tells the Court is along the lines of “I gave it away”.

Throughout the English common law systems, including the United States, the use of Dissociative Transfers have historically been prohibited as “fraudulent conveyances”. In the United States, most such transfers are prohibited by the Uniform Fraudulent Transfer Act (“UFTA”), which though not limited to Dissociative Transfers, is primarily aimed at such methods.

Dissociation Method: Hiding Money. Historically, a common method for a debtor to dissociate herself from an asset was simply to move the money abroad, or hide it in her backyard, and then to disclaim ownership or knowledge of its whereabouts. Clients who are in trouble seem to be inclined towards this tactic, “Well, I’ll just tell them I lost it gambling in Vegas” is a common refrain. Unfortunately, this tactic only works to the extent that the Client is willing to commit outright perjury, something that of course the planner cannot recommend or even be associated with (and in fact may be required to disclose to the court).

Dissociation Method: Naked Gift. The “midnight transfer” to an insider is another method by which Clients sometimes attempt to avoid the collection attempts of creditors.

Dissociation by gifting has historically been prohibited by the laws relating to fraudulent conveyances, and is codified by the Uniform Fraudulent Transfers Act.

Dissociation Method: Controlled Gifting. Where the debtor attempts to give assets away so as to avoid collection attempts, but still attempts to directly or indirectly control the assets, this is known as “Controlled Gifting”. This method takes various forms, and suggests that the debtor does not have effective control over the assets when in fact she does. These facades disingenuously attempt to hide the debtor’s control under the guise of such sophistry as “negative control” and other such terms. It is respectfully suggested that the niceties of such distinctions are not likely to be recognized by the courts.

“Controlled Gifting” probably accounts for the largest percentage of the “cookie cutter” asset protection plans being implemented, those structures primarily involving foreign asset protection trusts and family limited partnerships. Considering the sheer numbers of such plans which have been implemented in the last decade, and articles in professional journals, widespread dissemination of marketing materials, internet sites, etc., which expound the benefits of this structure, it will be difficult for a client to deny that such a structure has a fundamental asset protection purpose.

Not only have the Courts criticized in the harshest terms the use of Foreign Asset Protection Trusts, *see, e.g., FTC v. Affordable Media LLC*, 179 F. 3d 1228 (9th Cir. 1999) (“*Anderson*”); *In re Lawrence* 227 B.R. 907 (S.D.Fla. 1998), but the academic legal community has not been kind to Foreign Asset Protection Trusts, either. *See, e.g., R. Gingiss, Putting a Stop to “Asset Protection” Trusts*, 51 Baylor L. Rev. 987 (1999) (“Creditors or spouses who are disadvantaged by these shams are entitled to redress, the most effective of which is to take judicial notice of the sham and find in civil contempt each such settlor who does not effect repatriation of the trust assets. Failing that, statutes should be enacted to provide criminal penalties for those who establish self-settled trusts which can be made unavailable to satisfy an American judgment. * * * Self-settled asset protection trusts should become an oxymoron and put out of existence as a device to avoid creditors.”).

Professor Stewart E. Sterk of the Benjamin Cardozo School of Law concluded his excellent and lengthy article on the subject with this:

“Indirect sanctions against offshore trust settlers are somewhat more promising. As we have seen, courts have already imposed one such sanction on recalcitrant settlor-debtors: denial of the bankruptcy discharge. Another option is the modern-day equivalent of debtors’ prison: criminal sanctions for persons who establish trusts in jurisdictions that enforce spendthrift provisions in self-settled trusts. Some commentators have argued that the legal framework is already in place for incarcerating settlers of offshore trusts and that courts currently have power to imprison uncooperative settlers for civil contempt, criminal contempt, or bankruptcy fraud. * * * If criminal sanctions are appropriate, legislation that explicitly targets offshore trusts would be preferable. * * * The growth of the offshore trust, however, suggests that the costs of exporting assets no longer seems so daunting to so many people. If that trend expands, incarceration may well be the only available brake any individual government has on trust law’s international race for the bottom.”

S. Sterk, *Asset Protection Trusts: Trust Law’s Race to the Bottom?*, 85 Cornell L. Rev. 1035 (2000).

The Doctrine of Disbelief. An immediate problem with Controlled Gifting is that courts considering the issue may be skeptical as to whether the debtor has in fact given up control. This tendency of the courts to look through the form of foreign asset protection trust structures to the probable intent of the settlor to thwart creditors is aptly labeled the “Doctrine of Disbelief”.

While it is possible that a rational person would send millions of dollars overseas and retain absolutely no control over the assets, we share the district court's skepticism district court found, notwithstanding the Andersons' protestations, that “As I look at the totality of the scheme of what I see before me at this time, I have no doubt that the Andersons can if they wish to correct this problem and provide the means of putting these funds in a position that they can be accountable . . .”

FTC v. Affordable Media LLC, 179 F.3d at 1241-2 quoting Transcript of June 9, 1998

Hearing Regarding Plaintiff's Motion for Civil Contempt, p. 18.”

Of most significance, Judge Utschig found it “. . . impossible to believe the Debtor's testimony that he simply walked away from virtually all of his assets without any sort of struggle.” * * * He further stated: "This Court finds it impossible to believe that the Debtor surrendered ninety percent (90%) of his assets to a stranger on the other side of the world without maintaining some control over the assets."

In re Lawrence 227 B.R. 907 (S.D.Fla. 1998).

To the extent that the Court will not believe that the debtor has truly dissociated herself from her assets, the use of dissociative methods, including even very well-drafted foreign asset protection trusts, is likely to be ineffective.

TRANSFORMATIONAL METHODOLOGY

Introduction to Transformational Methodology. Transformation is the converting of assets from something that is readily available to creditors, into a form that is difficult or undesirable for creditors to attack. Typically, transformation methods seek to take advantage of *local* law that allows the asset to be protected, though often debtor's export their assets (and often themselves) to jurisdictions with more debtor-friendly laws.

Transformational Methodology: Homestead Exemptions. Probably the most widely used transformation method is the conversion from cash or other unprotected forms into property that is protected by state homestead laws, where applicable. Some states, most popularly Florida and Texas, have excellent homestead laws that potentially allow individual debtors to protect significant amounts of personal wealth in personal residences, annuities or life insurance products, etc., subject to some limitations.⁴

The use of the homestead exemptions is not without certain disadvantages. Although the asset may be protected from creditors, they may also be “trapped” within the exempt assets and not available for other use. Also, the exempt assets may be similarly “trapped” for purposes of gift or estate tax planning.

Transformational Methodology: Limited Interests. Another method of transforming assets involves the contribution by the debtor into a so-called “limited interest”, typically meaning into a limited partnership interest or non-managing LLC interest in states that limit the remedies of creditors of such interest holders to “charging orders.”

Limited interests are often used as a “first line” defense against creditors, meaning that assets are initially contributed to a limited partnership or LLC prior to the use of any other method of asset protection. Thus, the creditor first faces a difficult fight to penetrate the limited partnership or LLC, or to liquidate the “charged interest,” before the pursuit of assets can begin in earnest.

Transformational Methodology: Life Insurance. Although seemingly a pedantic topic, the use of life insurance for asset protection purposes has many excellent possibilities. Life insurance is protected from creditors in many states. In particular, “custom” or “private placement” life insurance policies that include specific “creditor unfriendly” language can be very subtle, yet effective means of asset protection

Transformational Methodology: Annuitization. The transformation of cash or other assets into periodic payments is called Annuitization. Instead of the creditor being satisfied from a single lump of assets, the creditor is instead forced to wait for the periodic payments – effectively meaning a lower present value for the creditor.

Annuitization essentially provides a “cover” for assets, meaning that the creditor gets some assets immediately (and therefore presumably will have difficulty in complaining to the court), giving the debtor time to avail herself of other techniques and thereby over time “bleed” assets from the entity making the annuity payments, until it is insolvent.

Transformational Methodology: Securitization. Securitization is the process of taking assets that are “free and clear” (*i.e.*, without encumbrances), stripping out the equity, and encumbering the assets with debt – preferably debt that exceeds the value of the property being stripped. The Securitization methods are typically used for illiquid and immovable assets, such as real estate.

Transformational Methodology: Monetization. Monetization Methodology involves the liquidation of assets into cash, and then the utilization of cash for investment into something that has equivalent long-term future

value, but no (or low) immediate cash value for creditors. A benefit of Monetization Methods is that they are demonstrably "for value," and the asset protection benefits are immediately effective upon the investment.

MIGRATIONAL METHODOLOGY

The process of creating multiple layers of entities, and then transferring assets through those layers until they are distanced from entities carrying potential liability, is known as "Migration".

Successful strategies employing Migration are typically planned well in advance, and through several layers and over a long period of time. After the assets have been transferred through a layer, the now-shell entities are sold to a foreign partner not subject to the jurisdiction of the local court, and then either liquidated (or more often kept "on the shelf" for possible future use after a pre-determined period of time has passed, say, five years).

REDEMPTIONAL METHODOLOGY

Redemptional Methodology seeks to eliminate unknown but potential past liability in an entity, by sale of the entity to a "liability proof" third party (often offshore), and then by purchasing back (a/k/a "redeeming") the core assets held by the entity into a new, presumably liability-free entity.

The principal benefit of Redemptional Methodology is that a third-party has been substituted within the chain of potential debtors, and that these methods are immediately effective upon the initial sale.

The primary disadvantages to the Redemption methods are lingering secondary liability, typical high expense involved in the structuring and transfers, and difficulty in planning and implementing these arrangements.

REPLICATIONAL METHODOLOGY

Replication involves the use of structured financial derivative products (and often so-called "exotic derivatives"), that in essence utilize the phenomena of time decay to remove assets from the debtor's portfolio, and then reconstitute those assets elsewhere, either immediately or after the passage of a fixed amount of time.

The advantage of the Replication methods is that they are immediately effective. Also, valuation issues involved with derivatives vary widely within the markets -- this makes it very difficult for a creditor to disprove that the transfer was “for value” or made for some reason other than the legitimate pursuit of financial gain.

The primary disadvantages of the Replication methods are, first, that they require the cooperation of a securities broker-dealer (or sometimes several broker-dealers) engaged in the trading of derivative instruments) and, second, that these arrangements are very complicated and difficult to plan and implement.

¹ Whether such cases as Anderson and Lawrence will ultimately be taken to have created a body of law known as “asset protection” remains to be seen. If these cases are any indication, the “law of asset protection” will have started on a very negative footing.

² *Preamble to Model Rules of Professional Conduct.*

³ Extra-judicial remedies are those not sanctioned by the law. Examples of extra-judicial remedies are often extreme, as where a creditor would through forgeries cause transfers from entities believed to be controlled by the debtor, or in extreme cases would kidnap the debtor’s child until the debt is paid, or simply kill the debtor in retribution.

⁴ One cannot, for instance, rob a bank and then run across the street and deposit the money into a mortgage company to pay off the loan, and expect that the money will be protected under homestead laws.