Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #199
Date: 23-Apr-12
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Jeff Galant: Default in Argentina, Repercussions in New York, Self-Settled Trusts and Choice of Law**

"A choice of law provision in a trust agreement, as is the case with any contract, may not be enforceable against persons who are not parties to the agreement. This point was recently reinforced by the U.S. Court of Appeals for the Second Circuit in EM Ltd., et.al. v. The Republic of Argentina which involved the validity of a self-settled trust created outside of the U.S. by parties who have basically no connection to the U.S. in terms of domicile or residence.

It is noteworthy that EM, Ltd. did not arise in the context of estate or asset protection planning. Clearly, EM, Ltd. is a reminder to those of us who prepare trust instruments that the law chosen to govern the trust may not be the law that a court will actually apply in a particular circumstance."

With Argentina once again in the headlines over the nationalization of its petroleum industry, **Jeff Galant's** commentary on EM Ltd. V. Argentina could not be timelier.

Jeffrey A. Galant, a tax and estate planning lawyer, is counsel at **Meltzer, Lippe, Goldstein & Breitstone LLP** in Mineola, New York. He has been selected as both a SuperLawyer and a Best Lawyer. He is an ACTEC fellow and President of 320-57 Corporation, a New York cooperative corporation. His practice is concentrated on tax and estate planning (including the planning for artists, collectors and art dealers), and family business succession planning.

Before we get to Jeff's commentary, members should note that a new **60 Second Planner** by **Andy DeMaio** on the recent case of Storey v. Commissioner was just posted to the **LISI** homepage. You don't need any special equipment - just click on this link.

Now, here is Jeff Galant's commentary:

EXECUTIVE SUMMARY:

A choice of law provision in a trust agreement, as is the case with any contract, may not be enforceable against persons who are not parties to the agreement. This point was recently reinforced by the U.S. Court of Appeals for the Second

Circuit in EM Ltd., et.al. v. The Republic of Argentina ("EM, Ltd.").[1] The case involves the validity of a self-settled trust created outside of the U.S. by parties who have basically no connection to the U.S. in terms of domicile or residence. It is noteworthy that EM, Ltd. did not arise in the context of estate or asset protection planning. This commentary concerns that case.

FACTS:

In the late 1990s, Argentina suffered a major financial crisis and to the chagrin of investors worldwide, defaulted on its $80 billion of global bonds that were issued earlier in the decade. Of course, this resulted in much litigation in the U.S. as well as elsewhere. EM, Ltd., a rather complex case, involved two hedge funds that owned some of the defaulted bonds and their pursuit of Argentinean assets in New York to satisfy their claims. Although much of the litigation with respect to this and related cases involved the application of the Foreign Sovereign Immunities Act of 1976 ("FSIA"), the focus here will be on certain aspects of New York law as it pertains to trust law, conflicts of law and rights of creditors.

Prior to its financial crisis, Argentina as part of a program of free market reforms developed a plan to substantially improve its infrastructure. Basically, the concept was to privatize a state-owned bank through the organization of a stock company (hereinafter, the "Bank") whose shares would be sold to the public and the sale proceeds would be used to finance the public works projects.

Legislation was passed establishing two trusts (the "Public Trusts") with an Argentine trustee ("BNA") for the purpose of obtaining the funding necessary to finance the projects. The Argentinean government caused the Bank to create the BH Trust, a trust under Argentine law with Argentine trustees, for the purpose of acquiring the Bank's class D shares, which would held by the BH Trust in the form of American Depository Shares (ADSs). The parties to the trust agreement of the BH Trust were the Bank, as settlor, and the trustees, including BNA. The BH Trust beneficiaries were the Public Trusts and its trust agreement expressly provided that the law of Argentina governed.

COMMENT:

To make a long story short, the hedge funds obtained judgments in the U.S.

district court in New York against Argentina with respect to the defaulted bonds and sought to attach the ADSs being held by the BH Trust in New York. New York law was determined to govern the attachments.[2] The feature of this case most interesting to trust and estate lawyers, especially those involved in asset protection planning, was the application of New York trust law to the question of the validity of the BH Trust.

The hedge funds, as judgment creditors of Argentina, argued that in effect Argentina was both the settlor and the beneficiary of the BH Trust and that under New York law the BH Trust, being a self-settled trust, was void as to creditors.[3] The U.S. district court and the Second Circuit agreed.[4]

Argentina argued that the ADSs held by the BH Trust belonged to the BH Trust and not to Argentina and, therefore, such property could not be attached to satisfy claims against Argentina. The threshold issue for the district court in New York was what law applied. Apparently, there is a split among the circuits in determining the appropriate choice of law rule under FSIA.[5] The district court held, and the Second Circuit affirmed, that the New York choice of law rule was the appropriate law to apply.[6]

New York's choice of law rule basically applies the substantive law of the jurisdiction having the greatest interest in the litigation[7]. Under such rule, although New York courts generally honor the substantive law chosen by the parties to an agreement, if a fundamental policy of New York law is affected by the litigation, a New York court will likely apply New York's substantive law. Therefore, notwithstanding that the trust was presumably valid under Argentine law, that all of the parties to the trust agreement were Argentinean and that the trust agreement expressly provided that the trust was to be governed by the law of Argentina, New York law was held to apply due to New York's very strong policy of not recognizing self-settled trusts.[8]

The district court found that the assets of the BH Trust were controlled directly by Argentina, since she had the authority to direct the disposition of the corpus for her own benefit. Based on such finding, and fully recognizing that the trust would be valid against Argentina's creditors under Argentine law, the Second Circuit determined that " … for reasons of long-standing public policy, New York law would not recognize the BH Trust as a valid trust entitled to protection against creditors."

Thus, the Second Circuit[9] held " … that, despite the choice of law provision in the BH Trust agreement purporting to establish a trust pursuant to Argentine law, New York law would not recognize it as such since enforcing the trust agreement would violate 'fundamental policies' of New York law." The Court stated that in New York "[i]t is against public policy to permit the settlor-beneficiary to tie up her own property in such a way that she can still enjoy it but can prevent her creditors from reaching it. Vanderbilt Credit Corp. v. Chase Manhattan Bank, NA, 100 A.D.2d 544, 546, 473 N.Y.S.2d 242, 246 (2d Dep't 1984)."

Furthermore, citing In re Portnoy, 201 B.R. 685, 698 (S.D.N.Y. 1996), the Second Circuit declared that under New York law "a judgment creditor may reach the corpus of the trust if the trust agreement grants the trustee the power to invade the corpus and pay the entire principal to the settlor."[10] Clearly, EM, Ltd. is a reminder to those of us who prepare trust instruments that the law chosen to govern the trust may not be the law that a court will actually apply in a particular circumstance.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jeff Galant

TECHNICAL EDITOR: DUNCAN OSBORNE

CITE AS:

LISI Asset Protection Planning Newsletter #199 (April 23, 2012) at http://www.leimbergservices.com.

CITATIONS:

---

[1] *EM Ltd., et. al. v. The Republic of Argentina, et. al.*, 2009 U.S. Dist. LEXIS 74184

(USDCSDNY 8/19/2009); 389 Fed. Appx. 38; 2010 U.S. App. LEXIS 17732 (2d Cir., 8/3/2010); cert denied, 131 S. Ct. 1474; 179 L.Ed. 2d 301; 2011 U.S. LEXIS 1452; 79 U.S.L.W. 3475 (U.S. Sup. Ct. 2/22/2011).

[2] Under the Federal Rules of Civil Procedure, a federal court employs the attachment and execution procedures provided by the law of the state in which the federal court sits.

[3] See section 7-3.1 of the New York Estates, Powers and Trusts Law.

[4] See footnote 1 above.

[5] See Petition for Writ of Certiorari, 2010 U.S. Briefs 572; 2010 U.S. S. Ct. Briefs LEXIS 4416 (U.S. Supreme Court 10/28/2010)

[6] See footnote 1 above. Other circuits would apply the federal common law choice of law rule, which apparently would lead to a different result in this case. See footnote 5 above.

[7] See, e.g., *Babcock v. Jackson,* 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 (N.Y. Ct App., 1963).

[8] See footnote 3.

[9] See footnote 1 above.

[10] It is noteworthy that the court in *Portnoy* applied New York substantive law and federal bankruptcy law notwithstanding that the trust was created in the Jersey Channel Islands and that the trust designated Jersey law as the governing law. The settlor in *Portnoy* was a U.S. domiciliary with New York contacts including the location of his business and the place where he worked as well as the place where the subject indebtedness was incurred and the place where the creditor was located. In *EM Ltd*., the settlor was Argentina and the trustees were Argentinean. Commentators have recommended that the courts limit *Portnoy* to its "bad facts" and give greater weight to governing law provisions chosen by the parties. See, for example, Rothschild, Rubin and Blattmachr, *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?* 32 Vand. J. Transnat'l L. 763 (1999).