"UNITED STATES CONTEMPT OF COURT PRINCIPLES AS APPLIED IN THE ASSET PROTECTION PLANNING CONTEXT"

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Introduction

Issues surrounding contempt of court have always been important to asset protection planners and their clients. And for good reason - few asset protection clients are interested in being held in contempt of court even if the assets remain protected through the process!

Is this a trade-off that must be made? Must a client ultimately move his person out of the country in order to ultimately protect his or her assets through an asset protection trust, as has been advised by one Cayman Islands-based commentator? The simple answer is, "no."

Both State and Federal Courts have broad discretion to impose sanctions on an individual found to be in contempt of court. Such penalties include money penalties, forfeiture of rights, and imprisonment. When analyzing the issue of whether a settlor of an asset protection trust (or any other trust for that matter) may be held in contempt of court, the court must consider whether the settlor's actions come within the definition of contempt, and whether any valid defenses exist. Under an asset protection trust that is properly drafted, properly implemented and properly administered, the "impossibility of performance" defense to a charge of contempt will be a complete defense to any such charge, so long as the impossibility is not "self-created" in close time proximity to the issuance of the court order or subpoena.

Definition of Contempt

Contempt is generally defined as an act of disobedience to an order of a court, or an act of disrespect of a court.1 For example, Colorado law defines contempt as one of the following actions that have the general effect of disobedience or disrespect for a court or an order of the court:2

1. Disorderly or disruptive behavior, a breach of the peace, boisterous conduct or violent disturbance toward the court, or conduct that unreasonably interrupts the due course of judicial proceedings;

2. Behavior that obstructs the administration of justice;

3. Disobedience or resistance by any person to, or interference with, any lawful writ, process, or order of the court; or

4. Any other act or omission designated as contempt by statute.

A party cannot be held in contempt unless he has willfully disobeyed a court order. 3 So, when a court orders a defendant to pay money or produce documents, the defendant must have the present ability to pay the funds or produce the documents requested at the time of the contempt proceedings before an order of contempt will stand.4

Particularly when the sanction to be imposed is imprisonment, the court will require a present ability to perform as of the time of the contempt hearing. For example, in Bowen (endnote 4), the Florida Supreme Court stated, "[b]ecause incarceration is utilized solely to obtain compliance, it must be used only when the contemnor has the ability to comply."

In civil matters, disobedience or resistance to a court order is the most common application of the rule. This is often referred to as indirect or constructive contempt because the act of disobedience is done out of the direct site or hearing of the court. Direct contempt occurs in the presence of the court at trial or during various court proceedings.

A further distinction to be made in the area of contempt law is whether the contempt charged is civil or criminal in nature. The difference between civil and criminal contempt is the remedy sought. If the purpose of the contempt order is remedial, such as to compel the contemnor to obey a court order, the contempt is civil. If the purpose of the contempt order is to punish past wrongful conduct, and thereby preserve the dignity and integrity of the court, the contempt is criminal.5

Impossibility of Performance: A Complete Defense

In any contempt proceeding for failure to obey a court order, the inability to obey the particular order is a complete defense.6 This is known as the "impossibility of performance" defense.

This defense will be available so long as the inability to comply or the impossibility to perform was not created by the individual to whom the order is directed at the time of, or close in time to, the court's order being issued.

The court will examine the nexus in time between the date the impossibility was created and the date the court's order issued. If a nexus is found between these two dates such that it can be shown by the requisite burden of proof that the defendant knew or reasonably should have known at the time the impossibility was created that a court order would enter (or a subpoena would issue), the court will likely find the impossibility was created in bad faith and the impossibility of performance defense will likely be lost.

The impossibility of performance defense is outlined by the Second Circuit Court of Appeals in the case of Badgley v. Santacroce:7

The purpose of civil contempt, broadly stated, is to compel a reluctant party to do what a court requires of him. Because compliance with a court's directive is the goal, an order of civil contempt is appropriate "only when it appears that obedience is within the power of the party being coerced by the order." Maggio v. Zeitz, 333 U.S. 56, 69, 92 L.Ed. 476, 68 S.Ct. 401 (1948). A court's power to impose coercive civil contempt is limited by an individual's ability to comply with the court's coercive order. Shillitani v. United States, 384 U.S. 364, 371, 16 L.Ed. 2d 622, 86 S.Ct. 1531 (1966); Maggio v. Zeitz, supra, 333 U.S. at 72-73. A party may defend against contempt by showing that his compliance is "factually impossible." United States v. Rylander, 460 U.S. 752, 757, 75 L.Ed. 2d 521, 103 S.Ct. 1548 (1983).

In the arena of asset protection planning, the creation and funding of the planning structure takes place well in advance of any dispute or claim giving rise to proceedings in which a subpoena, court order compelling action, or the like will issue. As such, the time nexus between the creation of the trust (i.e., what one might claim is the act that creates the inability to perform) and the issuance of some future subpoena or court order, will be absent. In this case, the defense of impossibility of performance can be expected to be a complete defense to a proceeding of contempt of court

When determining whether an alleged contemnor has the ability to comply with a court's order, the court is generally limited to examining the facts and circumstances that exist at the time the order is issued that create the impossibility on the part of the contemnor. Thus, in the Rylander case, 8 the court ordered Rylander to produce certain corporate documents. At the time the order entered, Rylander did not have possession of the documents and was no longer a corporate officer. Because insufficient proof was offered to show Rylander had actual possession of the documents and that he did not have access to the documents without committing some extreme act, the United States Supreme Court permitted his defense of impossibility and ruled Rylander could not be held in contempt of the court's order.

Self-Created Impossibility and Good Faith

Inability to comply with a court's order will not be recognized as a valid defense in those situations where the impossibility to perform was self-created for the specific purpose of

avoiding a court's order or subpoena that has been or is about to be issued.9 In other words, the mere fact that the defendant created the impossibility is not of particular relevance. It is when the defendant creates the impossibility that is important.

In situations where courts have examined the issue of self-created impossibility, the courts have consistently ruled that contempt will not apply unless the alleged contemnor acted in bad faith. Bad faith will not be found unless there exists some nexus in time between the creation of the impossibility and the issuance of the court's order or subpoena. In the Blaine case, 10 Blaine claimed he was unable to comply with a court's order to produce corporate documents, for which he served as president, on the basis he had transferred all of the documents to his attorney five months prior to being served with the subpoena. When the order to produce the documents was issued, Blaine's attorney returned the documents to him, but several files were missing. When the attorney and Blaine testified they did not know the whereabouts of the missing files, the court found no basis for a finding of bad faith and thus no contempt. Specifically, the court ruled, "it must appear by the legal preponderance of the evidence that . . . at the time of the service of the subpoena [the defendant] had possession or control of the documents."11

Contrast the result in Blaine with the result in Goldstein. In the latter case, the Second Circuit Court of Appeals found the defendant's inability to comply with a subpoena for the production of documents to have been created in bad faith.12 The defendant disposed of documents subject to the subpoena eleven days prior to the issuance of the subpoena and had reason to know the subpoena would be issued at or about the time he undertook to dispose of the documents. As such, the court found the defense of impossibility of performance to be ineffective.

Proving Good Faith

As part of the showing of good faith, the defendant needs to be prepared to prove there was no ability to perform. Specifically, the defendant must show he took steps within his power to comply with the court order and must offer proof to this extent.13 Furthermore, the inability must be shown to have existed for a period of time sufficient to avoid a nexus in time being established between the time the inability to perform arose and the time the order or subpoena issued.

For asset protection planning purposes, the earlier steps are taken to move the assets off-shore and into the complete control of the foreign trustee, the more likely the impossibility defense will prevail. Thus, the more tenuous the nexus in time, the more difficult it will be for the court to find bad faith on the part of the alleged contemnor. In addition, the defendant must make all reasonable attempts to comply with the court's order and adequately document all such efforts.

The Protector

The concept and role of the trust protector is often incorporated into offshore asset protection trusts. In most cases, the settlor of the asset protection trust will be the protector, at least initially.

The role of the protector may be described as a passive rather than an active one, for the control exercised over the asset protection trust by a protector is typically through negative powers, or veto powers. This fact notwithstanding, in the event a litigation threat arises against the settlor and/or the asset protection trust, an important issue requiring immediate attention is whether the protector should surrender office in favor of either an onshore successor, an offshore successor, or no successor. Surrendering office long before there is any possibility or certainty of a court order issuing will be critical to the failure of the requisite nexus in time.

The Anderson Case

No discussion of the law on contempt of court in the asset protection planning context would be complete without a discussion of the Anderson case. 14 Denyse and Michael Anderson, a San Diego couple, were incarcerated in a Las Vegas, Nevada jail on federal contempt charges for failure to repatriate trust assets.

The facts and the result of this case are entirely consistent with contempt law. Proper asset protection structures are designed to take contempt law into consideration. It does not appear that such was the case with the APT settled by the Andersons.

As the reader will gather from the principles established above, contempt law in the United States is quite clear - one cannot be held in contempt of court for failing to produce that which is impossible to produce. An exception to the impossibility of performance defense is the "self-created impossibility." However, for this exception to apply there must be a nexus in time between what one does to create the impossibility and the order as issued by the court.

In Anderson, and most unfortunately for the Andersons, the nexus in time between what was done to create the impossibility and the order of the court indeed clearly existed. First, the Andersons were trustees of the trust they settled (not a design the author would suggest or utilize). Second, the Andersons apparently remained as trustees throughout the litigation (not an approach the author would suggest or advise). Third, the Andersons were trustees even while the judge ordered them to repatriate the assets (not good). Thereafter, the Andersons notified the foreign trustee of their legal difficulties with the U.S. government and their situation of duress (bad timing). This resulted in the foreign trustee removing the Andersons as trustees and their becoming incapable of repatriating the assets.

Is it any surprise that the Andersons were jailed for contempt of court? Is it any surprise that the self-created impossibility exception to the impossibility of performance defense applied? After all, the Andersons had the power to repatriate the subject funds as of the

time of the court's order, and only lost that power when they tipped off the foreign trustee of their duress after the court's order had entered.

The reader will likely be interested in some language from a transcript of 1995 Contempt Proceedings involving a client of the author's firm and the planning structure created by the client. Therein, the judge states:

"I've reviewed the law regarding contempt and the standards that are required for me to hold Mr. [X] in contempt. That standard is clear and convincing proof, which means something more than preponderance of the evidence but something less than absolute certainty.

"One thing I've learned a long time ago as a judge, you never order something you can't enforce. And if we order him to pay a million dollars, I have to be assured that's a reasonable order. As a matter of fact, contempt law says that one should not issue orders that cannot be complied with. It's a violation of due process to issue orders that the respondent cannot comply with.

"I'd look pretty silly if I entered orders that couldn't be enforced.

"There's case law to the effect that if we issue a compliance order that the respondent does not have the ability to comply with, that's punishment and violation of due process.

"By putting him in prison, that doesn't compel compliance, because he does not have the ability, apparently, to comply."

These principles of United States contempt law were confirmed by a room full of judges when the author had the privilege to address the National Judicial College in Reno, Nevada a few years ago.

Closing

There is little a planner can do to protect a client from a "judge gone mad." There is a lot a planner can do to protect a client against an improper plan design, or to at least advise a client on the risks associated with incorporating unprotective plan design features (a la Anderson) which the client may for some reason wish to use in the overall plan.

Although contempt of court is a concern for any Settlor of an asset protection trust, it need not be a threat. Contempt is a remedy available to a court under only a limited set of circumstances. Its purpose is to compel obedience and punish disrespect. With proper planning, a trust settlor will witness the continued protection of the subject assets, and avoid a charge of contempt of court.

ENDNOTES

1 See e.g. Black's Law Dictionary, 4th Ed. p. 390 (West's 1968)
2 C.R.C.P. 107(a)(1)
3 Dragland v. Dragland, 613 So.2d 561 (Fla. 2d DCA 1993)
4 Bowen v. Bowen, 471 So.2d 1274 (Fla. 1985)
5 Fenton v. Walling, 139 F. 2d 608 (9th Cir. 1943)
6 United States v. Bryan, 339 U.S. 323, 330 (1950)
7 800 F.2d 33 (2nd Cir. 1986)
8 United States v. Rylander, 460 U.S. 752 (1983)
9 See 17 C.J.S. Contempt ß 19 (63)
10 See Federal Trade Commission v. Blaine, 308 F. Supp. 932 (N.D. Ga. 1970); see also Ex parte Fuller, 50 S.W. 2d 654 (Mo. 1932)
11 Id. at 932-33
12 United States v. Goldstein, 105 F.2d 150 (2nd Cir. 1939)
13 Stotler and Co. v. Able, 870 F.2d 1158 (7th Cir. 1989); Foust v. Denato, 175 N.W.2d 403 (Iowa 1970)
14 FTC v. Affordable Media, No. CV-5-98-00699-LDG(RLH)(D.Nev. 6/4/98)(Contempt Order issued against the Andersons)