THE FBL REPORT

Insight on the legal issues facing business today

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The FBL Report contains some of our most recent published articles and reflects our firm's commitment to remain current on prevalent corporate, international, tax, technology and asset protection issues. The report further reflects our goal to serve as a resource to sophisticated entrepreneurs, investors, and professional advisors. We welcome your thoughts and comments and remain available to address or speak on any issues, whether in the report or otherwise.

With warm regards,

Gary Forster
Managing Partner

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Front cover image: The State of Florida, our first step in expanding our focus beyond the Greater Orlando area, where we began just 3 short years ago.

Back cover image: The Americas, our current expansion focus and goal for growth over the coming years.

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"We couldn't be more appreciative of the overwhelming support received from our clients and contacts during our first three years. We will make every effort to continue to provide the highest standard of business and personal legal counsel."

– Gary Forster & Eric Boughman

Asset Protection Introduction - Considerations for the Financial Professional

By: Eric Boughman and Gary Forster

Published in *Accounting Today*

Effective asset protection requires the strategic use of several legal components. These include the transfer of assets to protective structures (such as limited liability companies and trusts), proper allocation of legally protected assets, insurance, and proper titling of assets to maximize legal exemptions from claims. Proper structuring insulates assets against claims from future, unknown creditors.

Timing is critical - this cannot be overstated. An effective plan must be implemented before clouds form. Existing and expected liabilities are not avoidable. Reactionary transfers - made to avoid liability - may be reversed and could entwine others in litigation, including recipients and professional advisors.

Take, for example, one client who owned and operated several successful franchises in Florida. Despite his financial success, animosity existed for several years between the franchisor and franchisee, culminating in non-renewal of the franchise agreements. A disagreement over termination and final accounting ultimately led to a lawsuit in the franchisor's home state where the court entered a judgment against the client for over $1.6 Million. Personal planning initiated prior to the lawsuit proved effective and the judgment was settled for less than ten cents to the dollar.

How is this possible? For one, the client owned very few assets in his own name. He was married and most personal assets were properly titled to maximize the benefits of marital ownership. His several real estate holdings were generally owned in protective structures such as multi-member LLCs with various partners, sometimes in a parent-subsidiary relationship. Cash and other liquid assets were held in entities designed to make maximum use of business entity laws in the state of formation. Business operations were structured to make best use of income exemptions.

The end and other liquid assets were held in entities designed to make maximum use of business entity laws in the state of formation. Business operations were structured to make best use of income exemptions. The end result is that the client owned very little personal assets available to satisfy the judgment. Nothing was hidden from the creditor. In fact, settlement talks picked up steam after we disclosed the client's organizational chart to the creditor's attorney. With no exposed assets, the creditor's recovery was limited to whatever the client was willing to offer to resolve the matter. Effective asset protection planning promotes favorable settlements.

Consider the result if the client had waited until the beginning of the lawsuit or after entry of the judgment to engage in asset protection planning. Most states' laws permit creditors to reach otherwise protected assets which are the subject of a "fraudulent transfer." These laws permit suit against both the debtor and the recipient of the transfer and empower creditors to reach assets intended to be transferred outside their grasp. Some states may even allow claims against third party professionals involved in the transfer. There have been cases in Florida, for example, where banks, financial advisors, and lawyers have been sued in connection with a fraudulent transfer. Regardless of the end result, being named in a lawsuit is never a good thing.

In our case study, had the client waited until being sued to initiate planning, any protective transfers or re-titling of assets may have exposed the client and others involved to a separate fraudulent transfer lawsuit to unwind the transfer. Business partners, the client's spouse, attorneys and any other professional advisors involved in the transfer may also have been dragged into the lawsuit.

Creditors can prove a fraudulent transfer by showing actual or constructive intent to hinder collection. Actual intent is a subjective analysis that depends generally on the debtor's state of mind. Such proof is implied through the debtor's actions and often relies upon innuendo and assumption.

By contrast, constructive intent generally requires showing that a debtor made a gratuitous transfer (i.e.: made without receiving "reasonably equivalent value") which left the debtor insolvent, undercapitalized, or otherwise unable to pay debts in a timely manner. These factors can often be demonstrated through valuation analysis, financial statements, and payment histories. As an objective analysis, constructive intent to avoid a creditor is generally easier to prove and is therefore usually the preferred fraudulent transfer attack by creditors.

The determination of solvency and reasonably equivalent value lie beyond the traditional expertise of legal counsel and often require advice from other professionals. Those financial professionals who may be called upon, such as accountants, valuation experts, and financial advisors, must understand the basic concepts of asset protection and fraudulent transfers.

If a client seeks asset protection advice or involves a financial advisor in a potentially fraudulent transfer, the advisor must understand the limits and potential pitfalls. Where fraudulent transfer laws are implicated, it is best to involve the advice of counsel experienced in the area. Asset protection involves several legal and financial components which, if not properly negotiated, can have potentially devastating legal ramifications. When a client seeks asset protection, always consider the implications of fraudulent transfers.

"Creditors can prove a fraudulent transfer by showing actual or constructive intent to hinder collection."

"Several years ago, we recognized certain weaknesses in the Nevis LLC law. Fortunately, the LLC Ordinance was recently updated with substantial improvements, including fraudulent transfer provisions we contributed. The following article explains the new law."

– Gary Forster

THE NEW NEVIS LLC

By: Gary Forster

Published in the American Bar Association's *Real Property, Trust, and Estate Law Journal*

The Nevis Limited Liability Company (Amendment) Ordinance (NLLCAO), 2015 (the "New Ordinance") strengthens and clarifies the prior Nevis Limited Liability Company Ordinance (NLLCO) of 1995 ("Prior Ordinance"). Among the improvements made by the New Ordinance are the addition of (1) fraudulent transfer provisions governing assets contributed to a Nevis LLC, (2) language prohibiting enforcement of foreign judgments against member equity, and (3) enhanced limitations on creditor remedies. This article explores several significant aspects of the New Ordinance.

Introduction

Nevis is a small island located in the West Indies of the Eastern Caribbean. Nevis is primarily known in the United States for being the birthplace of founding father Alexander Hamilton. Other historical significance includes a period during which Nevis was home to substantial sugar plantations and the hub of the English slave trade. Nevis is one of the two islands that constitute the Federation of St. Kitts and Nevis.

The first ordinance adopted in Nevis establishing a beneficial planning entity, the Nevis asset protection trust, was the Nevis International Exempt Trust Ordinance. See Nevis International Exempt Trust Ordinance (1994, as amended).

The trust ordinance was modeled on the Cook Islands International Trust Act, passed in 1984. The Nevis International Exempt Trust Ordinance offers several protective features, including prohibitions against the enforcement of foreign judgments against trust assets, limited fraudulent transfer remedies, and binding choice of law provisions. To complement the trust, Nevis adopted a limited liability company ordinance in 1995.

"The new ordinance makes strides to both prohibit domestications of foreign judgment and eliminate the threat of a foreign court."

Two Significant Prior Deficiencies

The Prior Ordinance contained significant omissions (Deficiencies). The Deficiencies included (1) a lack of prohibitions on registration (or domestication) of foreign judgments (to attach Nevis LLC equity) and (2) a lack of a fraudulent transfer law.

As discussed below, it is nearly impossible to determine the actual common law of Nevis from public research. Other than the statutes associated with protective entities and foreign investment, Nevis law is not available to the public. Nevis court opinions are unpublished. Thus, one is often left making inferences from the few available sources.

The First Deficiency: No Protection from Foreign Judgments

Under the Prior Ordinance, equity in a Nevis LLC was vulnerable to a foreign money or collection judgment in the creditor's home jurisdiction and registration or domestication by court order in Nevis. Because of the lack of statutory protection from registration of foreign judgments, a creditor with a foreign ruling could seek to have the ruling enforced through a Nevis court. The lack of statutory authority to deny registration or domestication made possible the successful attachment of an interest in a Nevis LLC through a foreign ruling.

The ability to domesticate a foreign judgment in Nevis left the Nevis LLC particularly exposed because of the intangible nature of the LLC interest. Most U.S. jurisdictions consider intangible property located wherever the owner is physically located. This leaves the LLC interest subject to the in rem jurisdiction of a court where a member-debtor is physically present. See Wells Fargo Bank, N.A. v. Barber, 85 F. Supp. 3d 1308 (MD. Fla. 2015). The LLC interest therefore becomes subject to the jurisdiction of the local court, with power over property located within its physical jurisdiction. A local court with such jurisdiction could then apply its own local law, presumably under a choice-of-law analysis, to order a local collection remedy not available in Nevis. The judgment allowing for collection of Nevis LLC equity could then potentially be registered, or domesticated, in Nevis. Registration in Nevis could permit the foreign creditor to reach LLC equity and the foreign assets held in the Nevis LLC. Nevis courts, under the Prior Ordinance, had neither the express authority to deny registration or enforcement of the judgment, nor the authority to prohibit collection on LLC membership interests. A statutory prohibition on registration and domestication was needed to force the creditor to again litigate the claim for damages in the LLC's home jurisdiction.

The Second Deficiency: Unbounded Fraudulent Transfer Law

The Prior Ordinance contained no fraudulent transfer provisions governing contributions to a Nevis LLC. Without statutory law governing a fraudulent transfer action, common law controls. See Bureau of Economic and Business Affairs, 2012 Investment Climate Statement, U.S. Department of State, http://www.state.gov/e/eb/rls/othr/ics/2012/191225.htm (June 2012) ("St. Kitts and Nevis bases its legal system on the British common law system"). Determining Nevis common law is difficult, however, because the St. Christopher and Nevis's constitution is not clear on governing legal principles when there is no legislative or constitutional authority. Most Nevis court opinions are sealed and therefore inaccessible The only Nevis-related opinions available to the public have come from the Privy Council or the Eastern Caribbean Courts, and neither has addressed the fraudulent transfer law in Nevis. Presumably, like many of Nevis's common law brethren, it would look to the laws of England to form the basis of its common law until such time as the legislature sought to abrogate the common law through enactment of legislation.

One case suggests that, because Nevis became independent from England, it was not bound by English common law. See Conway v. Queensway Trustees Ltd., [1999] ECSCJ No. 130. The Conway court relied on the manner by which Nevis gained independence from Great Britain to conclude that Nevis is no longer bound by British traditions (including the English common law of fraudulent transfers, found in the Statute 13 of Elizabeth).

The Statute 13 of Elizabeth (the Fraudulent Conveyances Act 1571) is particularly problematic for a transferor. A fraudulent transfer under the statute encompasses transfers colloquially referred to as “actual fraud" in U.S. jurisprudence, an often highly subjective determination. See Uniform Fraudulent Transfer Act§ 4 (transfer made with “actual intent to hinder, delay, or defraud"). See also Uniform Voidable Transactions Act § 4. In addition, an action for avoidance under the Statute 13 of Elizabeth is not subject to a statute of limitations.

There are suggestions that importation of English common law is what occurred in Nevis. For example, in Huggins v. Commissioner of Police, [2013] ECSCJ No. 0239, it is suggested that St. Kitts

and Nevis would have had to turn to the uncertain English common law to determine their rules for bail if it had not been for the adoption of the Bail Act 2012.

For fraudulent transfers, the law applicable to a Nevis LLC before the New Ordinance is unclear. Before the 2015 amendments, the use of a Nevis LLC could therefore actually increase the exposure of LLC assets to avoidance as a fraudulent transfer.

The Deficiencies came to the forefront as other jurisdictions adopted modem LLC and trust laws. See International Limited Liability Companies Act, 2011 (Belize). The New Ordinance eliminates these major deficiencies. The remainder of the article discusses the significant changes made to the Nevis ordinance.

The New Ordinance: Innovations and Remedying the Deficiencies

The New Ordinance prohibits enforcement of foreign remedies, adds fraudulent transfer law, and generally modernizes the Nevis LLC.

Preventing Domestication of Foreign Judgments

The New Ordinance makes strides to both prohibit domestication of foreign judgments and eliminate the threat of a foreign court awarding a remedy not recognized under Nevis law. The New Ordinance does not generally prohibit recognition of foreign judgments but bans enforcement of certain foreign remedies. The New Ordinance prohibits enforcement of any foreign judgment that grants a remedy not available under Nevis law. NLLCAO § 43(3). This eliminates remedies of particular concern, including access by a creditor to LLC property, foreclosure of a member's interest, and certain avoidance of fraudulently transferred property.

The New Ordinance prohibits enforcement of foreign remedies against LLC equity by adopting multiple nonrecognition provisions that prevent the application of foreign law. The first of the nonrecognition provisions provides that a judgment from a foreign court will not be enforced against a member's interest "to the extent the judgement purports to charge, mortgage, levy, attach, assign, or in any other way to affect the member's interest." NLLCAO § 43(3)(b). This language precludes a judgment creditor from obtaining a collection remedy in a foreign jurisdiction to collect on LLC equity and domesticating the judgment to enforce the remedy. A judgment creditor is now forced to relitigate the remedial portion of the claim. in a Nevis court. Further, the creditor is limited to a severely restricted charging order under Nevis law.

The second nonrecognition provision overlaps with section 43(3)(b). Section 43(8) provides that "no court order in any jurisdiction that purports to provide the redress or remedy set forth in subsection (7) shall be enforceable or enforced." Section 43(7) prohibits a creditor with a charging order from directly affecting the property or management of an LLC. Section 43(8) therefore prevents a Nevis court from recognizing a judgment that awards a remedy that "liquidates or seizes the assets" of the LLC. Specifically, a creditor cannot

- become an assignee of the member's interest,
- hold or be entitled to a member's rights in relation to that interest,
- interfere with the management of the LLC,
- liquidate or seize assets,
- restrict the business of the LLC, or
- dissolve or cause the dissolution of the LLC.

NLLCAO § 43(7).

On its own, section 43(7) serves little purpose because a charging order is the only remedy permitted under Nevis law. The charging order itself is narrowly defined in the Act and prevents a creditor from acting directly on LLC assets or management. Section 43(7) is apparently intended to override any conflict of law issues that may arise in other jurisdictions applying local law in resolving a collection dispute.

Note that property located in the creditor's home jurisdiction may not be protected by this section. Section 43(8) could be ignored by a foreign court enforcing its order under local law, by applying the local LLC statute and collection law against LLC equity or property located in its in rem jurisdiction. A Florida district court ruled that the law of the court with jurisdiction over the interest or property controls, and not the law of country of formation. See Wells Fargo Bank, N.A., 85 F. Supp. 3d at 1316. The district court analyzed the choice of law analysis under Nevis's prior statute and held that Florida law was applicable. The opinion indicates that the language added to the current Nevis statute would have been inconsequential to the analysis. See id.; but cf. Arayos, LLC v. Jimmie Ellis, No. 15-0027-WS-M, 2016 U.S. Dist. LEXIS 54685 (SD. Ala. Apr. 25, 2016) (holding that the Alabama LLC statute did not give authority to issue a charging order on an LLC formed in a state other than Alabama).

Sections 43(3)(b) and 43(8) prohibit enforcement of a foreign collection order against a Nevis LLC or membership equity but do not address a fraudulent transfer judgment obtained in a foreign jurisdiction. A fraudulent transfer claim is not a creditor right, but a remedy available to a creditor to avoid or unwind a transaction, making assets available for seizure or liquidation. Section 43A covers the avoidance of transferred property and monetary liability of the LLC for the value of fraudulently transferred property.

Section 43A(9)(b) states that "[n]o judgment obtained in a foreign jurisdiction in respect of any remedy described in section 43A(1) shall be recognized or enforced by the Court." Thus, Nevis courts may not enforce any foreign judgment ordering an avoidance of property or holding a LLC liable for the value of property fraudulently transferred to a Nevis LLC.

The nonrecognition provisions taken together require the relitigation in Nevis of any creditor remedy attaching a membership interest or granting access to LLC property, either directly or indirectly. The nonrecognition provisions insulate property held by a Nevis LLC in Nevis and in any other jurisdiction respecting foreign LLC law from foreign courts. These limitations create some certainty as to the maximum exposure a member faces in a Nevis court from a foreign creditor. That exposure is the Nevis charging order or a Nevis fraudulent transfer claim, both of which are very limited in scope.

Note that new section 43(3) does not prevent the creditor from domesticating a monetary judgment. A creditor effectively faces no barrier to obtaining a charging order under Nevis law, so long as the creditor domesticates the foreign money judgment before the expiration of the statute of limitations.

Protecting Against the Fraudulent Transfer

Fraudulent transfer is likely the greatest vulnerability a Nevis LLC faced under the Prior Ordinance. Fraudulent transfers to a Nevis LLC were likely subject to the creditor-friendly Statute 13 of Elizabeth. Consequently, fraudulent transfer actions in Nevis by a creditor of a member for assets in a Nevis LLC were likely not subject to a statute of limitations. Fraudulent transfers were also likely avoidable under a somewhat subjective standard, similar to what is commonly referred to in the United States as "actual fraud." Consequently, the new fraudulent transfer law is much more protective of LLC assets, especially if held in Nevis or a different jurisdiction respecting foreign LLC law.

The Standard of Proof

To establish a transfer as "fraudulent" under the New Ordinance, the creditor must prove all elements beyond a reasonable doubt, the highest evidentiary burden in law. NLLCAO § 43A(1). This evidentiary standard is particularly burdensome in light of the New Ordinance requiring proof of debtor insolvency and the associated valuation of the transferor's assets. Ascertaining the value of a particular property is an inexact science, and the failure to establish property value beyond a reasonable doubt may make proof of insolvency practically impossible.

The Elements of a Fraudulent Transfer Under the New Ordinance

To successfully execute a fraudulent transfer claim, a creditor must prove beyond a reasonable doubt that

1. *The claimant is a creditor of the member.*

2. *The transfer was made by or for the benefit of the member.*

3. *The transfer was made with the "principal intent" to defraud the creditor;*

4. *The transfer rendered the member "insolvent or without property."*

NLLCAO § 43A(1).

Establishing the claimant as a creditor and that the transfer was made by the member or for the benefit of the member are generally simple background facts. "Creditor" is broadly defined to include anyone with a cause of action against the debtor, and the beneficiary of a transfer is usually obvious. NLLCAO § 43A(11).

Third, a creditor must prove that the transfer is made with the principal intent to defraud the creditor. The use of the word "principal" means that it is not sufficient for the creditor to prove that the debtor intended to defraud the creditor. The creditor must prove that it is the primary intent of the debtor to defraud the creditor bringing the claim, that is, avoidance was the debtor's main reason for transferring the asset. A myriad of other reasons may exist for the transfer, such as a business purpose, estate planning, or even potentially the intent to defraud a different creditor.

Fourth, a creditor must prove that the transfer renders the member-debtor insolvent or without property to satisfy the debt. The fourth element is effectively a valuation exercise. As noted above, the validity of asset valuations is difficult to prove, especially under a reasonable doubt standard. If a member is borderline insolvent, even slight variations in property value could create doubt.

To prove insolvency, the creditor must demonstrate that the value of the member's property, which includes the value of the LLC interest received, is not more than the member-debtor's total debts or that the debtor is otherwise without property to satisfy the creditor's claim. If the creditor is unable to prove either that the value of the member's property has decreased to the point of insolvency or that the debtor is otherwise without property to satisfy the claim, then the fraudulent transfer remedy is unavailable.

The fourth solvency element can render transfers by a member to a single-member LLC practically immune from a fraudulent transfer claim. Section 43A(2) provides that in determining insolvency, the fair market value of the member's interest immediately after the transfer should be taken into account. NLLCAO § 43A(2). Such language was submitted to address the propensity of U.S. courts to exclude protected assets from the solvency calculation.

When an asset is transferred to an LLC, especially a single-member LLC, there is likely little or no decline in the relative value, which is the value of the asset transferred versus the value of the membership interest received. A member's total property value, including LLC equity received, before and after transfer to a single-member LLC is therefore practically identical. A member-debtor of a single-member LLC and potentially multi-member LLC will likely have a similar net worth after the transfer and therefore will not be "rendered ... insolvent or without property." Id. The decline in relative value may be greater when an asset is transferred to a multi-member LLC in exchange for a membership interest, because of factors such as combined asset values and loss of control.

The heightened standard to prove fraudulent transfer presents an additional and substantial creditor burden. If the elements and standard of proof fail to dissuade a creditor from bringing a fraudulent transfer action, the other provisions in section 43A may.

Dissuading the Creditor

Several additional provisions of the New Ordinance impede creditors from bringing a fraudulent transfer action in Nevis.

A creditor initially faces not only the general financial burden of bringing a fraudulent transfer action (to pursue LLC assets) but can also be liable for the litigation costs of the debtor. The costs are not limited to attorney's fees, but include the total costs incurred in defending the claim. A Nevis court has discretion to order payment of costs and expenses incurred by the opposing party (directly or incidentally) in relation to a fraudulent transfer claim. The court has the power to award costs and expenses to either side, regardless of the outcome. See NLLCAO §43A(15). This differs from traditional fee shifting provisions that award attorney's fees only to the prevailing party.

The creditor suing for fraudulent transfer under the New Ordinance also must obtain a bond in the amount of $100,000 from a Nevis financial institution. NLLCAO § 43A(16). The bond must be posted with the Nevis Permanent Secretary in the Ministry of Finance. Id. The bond secures the payment of all creditor costs resulting from the fraudulent transfer action.

Furthermore, even if a creditor prevails, the creditor remains responsible for the total costs incurred by the LLC and any other members in defending the action if the LLC or member are found not to have acted in bad faith. The creditor's property avoided will be encumbered by the LLC's or member's "first and paramount" charge over the property, securing reimbursement, subject to the fraudulent transfer action. NLLCAO § 43A(12).

The charge against the asset can be a substantial obstacle to collection. Take for example, an LLC with two members, A and B. A fraudulently transfers property X to the LLC. B, as part of his ordinary distributions, is distributed property X. Creditor C sues the LLC and B to recover the value of the asset. Assuming that the transfer of X from the LLC to B is voidable, the LLC is treated as owning the asset avoided, or the value of the asset may directly be recoverable from B, if the asset itself cannot be recovered or the transaction is not feasible to unwind C can recover only the value of the asset equal to A's interest in the asset at the time of transfer.

Assuming that the asset transfer can be unwound to satisfy C's claim, the LLC must either transfer the now avoided asset to C or sell the asset. Before the sale or transfer, B and the LLC, if not acting in bad faith, can obtain a "charge" on the asset for the entire cost of their expense in defending the claim. C is left with any funds remaining.

The incidental costs of suing abroad, the litigation costs of the debtor, the cost of posting bond to secure litigation costs, collateral LLC and member costs, and the LLC's right to charge the property avoided, coupled with the requirement that a creditor must prove its case beyond a reasonable doubt, will likely dissuade all but the largest and most well-funded creditors.

Obstacles to Proving a Fraudulent Transfer

As noted, the creditor must establish the elements of fraudulent transfer beyond a reasonable doubt. The New Ordinance limits the evidence a creditor may use to establish a fraudulent transfer, making it more difficult to meet the already high burden of proof. The New Ordinance prohibits proof of fraudulent transfer by means of a single piece of evidence to establish a prima facie case of fraudulent transfer. This prohibition means that certain facts, in a vacuum, are insufficient to establish a fraudulent transfer. NLLCAO § 43A(5).

Two different factual scenarios are provided as examples in the New Ordinance. Neither may independently serve as the sole reason for a court to conclude that the transferor had intent to defraud a creditor.

First, a court cannot conclude that a member-debtor had the intent to defraud a creditor because a transfer was made to the LLC within two years of the creditor's cause of action accruing. Id. A creditor must present more evidence than simply that a transfer occurred after the claim accrued. The restriction seems reasonable because the mere fact that a transfer was made after an event of liability is likely insufficient to demonstrate beyond a reasonable doubt that the member-debtor's "primary intent" was to defraud the creditor.

Second, the fact that a member-debtor enjoys the powers or benefits of a member or a manager is not a sufficient basis to conclude that the member-debtor had the intent to defraud a creditor. Id. This prevents a court from concluding that, because the member-debtor retains a beneficial interest or control over the property, the intent was to defraud a creditor. It is unclear whether section 43A(5) allows a court to consider both factual settings to conclude that there was sufficient intent to defraud. The use of "solely" and "or" can be read to mean that either factual scenario on its own is an insufficient basis for fraudulent intent while not prohibiting the conclusion that the

transferor had the intent to defraud when both facts are present. The intent of the section suggests that neither, nor both together, is a sufficient base for concluding that the member- debtor had intent to defraud.

The amendments limit any presumption of intent by placing the onus of proof on the creditor to show that the member acted with the specific intent to defraud the creditor (through acts beyond the timing of the transfer and control of the LLC). NLLCAO § 43A(7). These provisions eliminate two "badges" of intent to avoid a creditor-(1) action taken to secure exposed assets by transfer made after the creditor's cause of action accrued and (2) the retention of control over the property transferred. Without more, the creditor legally cannot prove intent to defraud the creditor. No set of facts will shift the burden to the member.

Statute of Limitations

A Nevis LLC and its members no longer face a potentially eternal claims period for a fraudulent transfer action under Nevis law. It is likely that under the common law the equitable doctrine of laches could be invoked as a defense to a fraudulent transfer action brought after a significant time after transfer. Absent court intervention and no statutory expression of limitation, however, the possibility existed that a fraudulent transfer action could have been brought at any time in Nevis.

The new statute of limitations begins running early and expires quickly. To bring a cause of action to recover a transferred asset, the transfer must have occurred after the claim “accrued or had arisen." NLLCAO § 43A(4). A claim accrues on "the date of that act or omission which shall be relied upon to either partly or wholly establish the cause of action ..."NLLCAO § 43A(8). A cause of action is defined as the “earliest cause of action capable of assertion by a creditor against the member or, as the case may be, against the member of property upon a limited liability company, by which that creditor has established (or may establish) an enforceable claim against that initial member." NLLCAO § 43A(8)(a). If more than one act or omission is ongoing, then the claim accrues on the date of the earliest act or omission that would have given rise to the cause of action. NLLCAO § 43A(8). It is also important to note that an entry of a judgment does not constitute a separate cause of action. NLLCAO § 43A(8)(b). The statute of limitations begins to run at the time the claim accrues, without regard to the creditor's knowledge of any transfer of assets. This eliminates the standard U.S. "knowledge exception," leaving the limitations period open indefinitely.

A fraudulent transfer action is barred by the statute of limitations under either of two conditions. If the transfer occurs more than two years "from the date of [the] creditor's cause of action accruing," then the fraudulent transfer claim cannot be brought by a creditor of the member. NLLCAO § 43A(3). If the transfer occurs within the two- year period from the date of accrual (whether the transfer is made by establishment of the LLC or disposition to the LLC), the creditor has only one year from the date of the transfer to bring the cause of action. Id.

The statute of limitations gives the creditor very little time. The creditor that suffers a contract breach or a loan default is likely not contemplating a fraudulent transfer or the titling of offshore assets. By the time a creditor realizes that it must avail itself of a Nevis court (to seek a fraudulent transfer remedy), the creditor may be time barred. This can occur even before starting the judicial process in the creditor's home jurisdiction. There also are limitations on the recovery of Nevis LLC assets subject to a fraudulent transfer action. A creditor may not reverse a fraudulent transfer of property to the LLC. The LLC is instead liable only for an amount equal to the value of the member's interest in the property at the time of transfer. NLLCAO § 43A(1).

To satisfy the claim, the LLC can transfer the asset to the creditor or conduct a sale of the asset and distribute the proceeds to the creditor. A creditor's recovery is limited to recovering from the asset. The creditor has no right to recover value transferred from any other member, manager, or property of the LLC. Limiting recovery to the asset shifts the risk from the LLC transferee to the creditor for any depreciation in value between the time of the transfer and the filing of the "fraudulent" transfer action. NLLCAO § 43A(6).

“Fraudent transfer is likely the greatest vulnerability a Nevis LLC faced under the prior ordinance.”

A creditor is provided some limited protections to recover. The amendments prevent the disposal of the asset subject to the fraudulent transfer action in a transfer that is not a bona fide sale madefor "full and adequate" value. Sales of assets transferred to the LLC by the LLC for less than reasonable value are therefore void. NLLCAO § 43A(6)(a).

Eliminating the Danger of Judicial Activism

The New Ordinance provides that a creditor of a member may not be awarded any remedy "of any type, legal or equitable" against a member's interest. NLLCAO § 43(3)(a). This limitation includes, but is not limited to, "foreclosure, seizure, levy, or attachment of the member's interest or ... an accounting." Id. Such language prohibits equitable rulings by a Nevis court or foreign court respecting Nevis law to force the member to do or refrain from doing something, such as turn over property.

The New Ordinance further prohibits direct access to assets of the LLC. NLLCAO § 43(5). The New Ordinance states: "No judgment creditor of a member or a member's assignee has any rights to obtain possession of, or otherwise exercise legal or equitable remedies ... " against the property of the LLC. Id. The language precludes the court from empowering the creditor to reach LLC property as a basis for satisfying a judgment.

New Section 43: Updated Charging Order Provisions

The charging order provisions in the Prior Ordinance were eliminated and rewritten in the New Ordinance. The New Ordinance adopts portions of the Prior Ordinance, but, for the most part, it is an entirely new provision. It separately defines the rights of a creditor, a member, and the LLC when a collection action is brought against a member's interest.

As a matter of background, general confusion exists among state legislatures and practitioners regarding the difference between the foreclosure of a membership interest and issuing a charging order. Foreclosure of a membership interest allows for transfer of the entire ownership interest, or all a member's rights. In contrast, a charging order generally entitles the holder solely to the economic benefits of the membership interest. The other rights, such as participation and managerial rights, are left undisturbed. Foreclosing a charging order, when permitted, is only a foreclosure of the economic interest. In most cases, this creates little practical creditor advantage or interest in LLC assets because permitting foreclosure and sale of the economic interest does not augment collection rights.

The Charging Order on Single-Member Limited Liability Companies

Section 43(1) provides a single remedy to a member's creditors-the charging order. The New Ordinance provides that [n]otwithstanding any other law, the remedies provided by subsection (1) shall be the sole remedies available to any creditor of a member's interest whether the limited liability company has a single member or multiple members." NLLCAO § 43(3) (emphasis added).

The language is apparently an effort to avoid the U.S. trend to reject the charging order as the exclusive remedy against equity in a single-member LLC. The "exclusive remedy" language in the Prior Ordinance was more conclusory than the U.S. statutes at issue. It, nevertheless, remained exposed to the argument, made with success in the United States, that the charging order is intended to protect other members and that such purpose is not fulfilled in a single-member scenario. See Gary Forster, Asset Protection for Professionals, Entrepreneurs & Investors 167-71 (2013), for a discussion of the cases that lead some jurisdictions to reject the charging order as the exclusive remedy regarding equity in a single-member LLC.

The Applicability of the Charging Order

The New Ordinance clarifies who may obtain a charging order. In the Prior Ordinance, a bankruptcy trustee was not specifically included in the definition of judgment creditor. The omission left open the argument that a bankruptcy trustee could claim a different remedy. NLLCO § 43(1). This is because a debtor does not "owe" something to the bankruptcy trustee (afforded onerous collection rights). Bankruptcy trustees are not judgment creditors. They are a statutory creation endowed with the power to seek equitable remedies that transcend the rights of ordinary judgment creditors.

Absent the inclusion of such a statutory provision, a bankruptcy trustee may not fall within the definition of a judgment creditor. Under the Prior Ordinance, it was therefore possible for a bankruptcy trustee to avoid the charging order restrictions. The New Ordinance specifically includes bankruptcy trustees as creditors of a member, limiting the trustee to the charging order rights afforded a private judgment creditor. Id.

Defining Creditor Rights

The New Ordinance also defines the rights a charging order provides a judgment creditor and the rights a member retains in his interest. Under the Prior Ordinance, a judgment creditor was entitled to the "rights of an assignee of a member's interest." NLLCO § 43(1). The "rights of an assignee of a member's interest" is both ambiguous and susceptible to various interpretations-including the interpretation that equity in a single-member LLC may be subject to foreclosure. The New Ordinance replaces such language and limits a creditor with a charging order to distributions made to the member from the LLC. NLLCAO § 43(1)(a) ("A charging order shall entitle the judgment creditor to receive any distributions, in relation to that member's interest, ... whether of income or capital, but only as and when made by the limited liability company").

The creditor receives only distributions and only when and if made. The judgment creditor has no power to compel distributions or manage LLC operations. Creditor rights are affirmatively limited by section 43(7) of the New Ordinance, which prohibits interference with the assets or business of the LLC.

The New Ordinance also defines the rights of a member whose interest is subject to a charging order. In the Prior Ordinance, the rights of the debtor member were undefined. See NLLCO § 43. The debtor member's rights could be inferred as whatever LLC rights an assignee did not obtain. The history of the charging order suggests that a creditor with a charge should be limited to distributions but (without any confirming case law) a court could reach a different conclusion.

The New Ordinance eliminates the ambiguity by providing that the rights of a member whose interest is subject to a charging order retains all "his membership rights and obligations ... as if the charging order had not been issued." NLLCAO § 43(9). The debtor-member will therefore suffer no change in managerial capacity. The creditor is limited to the distributions a member would be entitled to receive, but management continues to reside in the members.

The New Ordinance also defines the rights of the LLC regarding the member whose interest is charged. A charging order does not affect the LLC's ability to make calls on its members. NLLCAO § 43(13).

A distribution made (but retained) to satisfy a call is not subject to a charging order. Id. The call may be satisfied by a distribution otherwise payable to the debtor-member.

Sheltering distributions through capital calls potentially allows for continued investment by the LLC. An LLC could therefore order a call before making a distribution. This would likely preserve the value of any otherwise charged distribution by means of a mandatory reinvestment of the called distribution. Distribution by a single-member LLC called for reinvestment could even potentially avoid exposure to a fraudulent transfer claim, as the call and reinvestment likely effect no change in the economic position of the member.

"The creditor suing for fraudent transfer under the new ordinance also must obtain a bond in the amount of $100,000 from Nevis financial institution."

Curbing the Charge

The New Ordinance limits any charging order of a Nevis LLC interest to the amount of the judgment. NLLCAO § 43(1). The charging order cannot be used to collect beyond the amount of the judgment for either actual or consequential damages. The creditor also may not collect punitive or treble damages. Id.

The charging order under the New Ordinance differs from the traditional charging order that persists indefinitely until the judgment is satisfied. Under the New Ordinance, three years after the charging order is issued, it terminates and is not renewable. NLLCAO § 43(11). A creditor is limited to a single, one-time charging order against a member's interest. Id. That charging order remains in effect for three years, leaving the member and LLC assets undisturbed. The time limitation affords the debtor-member leverage to wait out the creditor or force the creditor into settlement if the member's other assets are protected.

The charging order is further curbed by language allowing a member to petition for discharge of a charging order. The petition is available to any member of the LLC, including a member whose interest is subject to a charging order. See NLLCAO § 43(12) ("Any member may apply for the discharge of a charging order"). The amendment provides two bases for discharge.

The first basis for a petition of discharge requires the court to discharge the charging order when the creditor has been "paid all sums payable under the charging order." NLLCAO § 43(12). Before these amendments, the charging order apparently expired naturally once the debt was satisfied. See NLLCO § 43. The new requirement that a member go to court to have the charging order lifted forces the creditor and member-debtor into a proper forum for any payment dispute. The resulting court order also creates closure. The second basis for a petition for discharge gives the court the discretion to discharge the charging order on its conclusion that "the circumstances giving rise to the charging order have changed such that it is just and proper to discharge the charging order." NLLCAO § 43(12)(b). Any change in the relationship between the creditor and the debtor can be a basis to support a petition for discharge. This language potentially allows the member to seek discharge of the charging order whenever circumstances change. The scope of the right to discharge based on a change in circumstances is unclear.

"The New ordinance also defines the rights a charging order provides a judgment creditor and the rights a member retains in his interest."

Charging Order Not a Lien

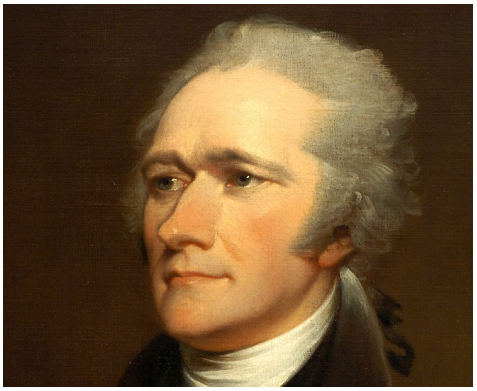
New section 43(6) provides that a charging order "shall not be construed to constitute a lien on a member's interest ..." NLLCAO § 43(6). The language was likely intended to prevent the encumbrance and foreclosure of a member's interest. This section seems to have limited purpose, because other sections of the Ordinance prevent foreclosure.

Section 43(6) seems targeted particularly at American law and more specifically at the Revised Uniform Limited Liability Act, which states that a charging order "constitutes a lien" on the interest. Rev. Unif. LLC Act§ 503(a). As a matter of background, the lien is a device that originated in civil law adopted into American law by Thomas Jefferson. See Charles Davidson, The Mechanic's Lien Law offllinois: A Lawyer's Brief upon the Topic 6 (1922). A lien is the primary method by which a creditor denotes interest in a debtor's property (garnishment and attachment being the others). Under American law, the charging order gives rise to a lien that attaches to a member's interest. Arkansas City v. Anderson, 752 P.2d 673, 684 (Kan. 1988). Practically, however, U.S. lien law would likely be given little effect in a Nevis court.

As Nevis law is likely derived from English common law, a charging order would likely be treated as a remedy distinct from a lien. See Fredrick Walton Atickson, The Law and Practice Relating to Solicitor's Liens and Charging Orders 1, 9 (1905). The charging order is the remedy by which a judgment creditor took an interest in the judgment debtor's property, but a lien under English common law is a possessory interest in property. Judgments Act 1838, 1 & 2 Viet., c. 110, § XIV (Eng.). See also generally Lancelot Hall, Possessory Liens in English Law (1917). Of course, a foreign court, particularly a U.S. court, may ignore Nevis law and its origins on the issue of remedies affecting a member's interest. See Wells Fargo Bank, N.A., 85 F. Supp. 3d at 1308.

Conclusion

The New Nevis LLC Ordinance clarifies and enhances the Prior Ordinance. Foreign judgments against a member are no longer a threat to assets held in a Nevis LLC if the assets are held in Nevis or in another jurisdiction respecting the New Ordinance. The Nevis Ordinance specifically applies to the single-member LLC. A creditor attempting to collect in Nevis must now relitigate the remedial portion of a foreign judgment in Nevis. The sole remedy against Nevis LLC equity, the charging order, is limited to the amount of the judgment, if it can be collected within three years. Lastly, fraudulent transfers to a Nevis LLC are no longer the major vulnerability they once were. A creditor seeking assets in Nevis or in other jurisdictions respecting the New Ordinance must relitigate a fraudulent transfer claim by proving his case "beyond a reasonable doubt." The creditor is left with a limited and unattractive remedy. For practitioners and their clients, these are welcome additions that strengthen and update the Nevis limited liability company.



"Foreign judgments against a member are no longer a threat to assets held in a Nevis LLC if the assets are held in Nevis or in another jurisdiction respecting the New Ordinance."

The Uniform Voidable Transactions Act

An Overview of Refinements to The Uniform Fraudulent Transfer Act

By: Gary A. Forster and Eric C. Boughman

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Introduction

The Uniform Voidable Transactions Act (UVTA) was recently adopted by the Uniform Law Commission (Commission) as the successor to the Uniform Fraudulent Transfer Act (UFTA). UFTA was itself an update of its predecessor, the Uniform Fraudulent Conveyance Act (UFCA). UFCA was revised to conform the Act to the Bankruptcy Reform Act of 1978. UVTA resolves several "narrowly-defined issues." UVTA Prefatory Note 5 (2014).

The prevailing purposes for the UVTA amendments appear to be codification of a choice of law rule and to ameliorate divergent interpretations of the Act among the courts. The divergence has led to varying outcomes of similar claims under UFTA (which failed to create the uniformity desired). See UVTA. §4, cmt. 10 (2014). The changes also bring the uniform act into compliance with the UCC and Bankruptcy Code. UVTA offers some welcome clarity to an all too often misunderstood body of law.

The alterations to UFTA include a few definitional changes that modernize the Act. Updates also include a codified choice of law rule, an exception for UCC Article 9 security interests, the elimination of the separate insolvency definition for partnerships, clarity as to which party carries the burden of proof, and a defined evidentiary standard for seeking a remedy under the Act. Furthermore, the Commission updated and added comments to influence the application of UVTA, as adopted by the States. Some of the comments are worth noting, and (if adopted by the courts) the comments have the potential to change the avoidance analysis in some jurisdictions.

"Fraudulent" to "Voidable"

The most noticeable change made in the UVTA is the absence of the word fraudulent from the title and body of the act. In UFTA, "fraudulent" and "voidable" are used inconsistently to refer to transactions for which the act provided a remedy. UVTA replaces "fraudulent" with "voidable" to clear up the inconsistency. Another purpose of the change is to discourage the "oxymoronic usage" of the phrase "constructive fraud" and the misleading phrase "actual fraud". UVTA §14, cmt. 1 (2014).

The use of these phrases perpetuates the confusion and inconsistent application of the act among the courts. The prior language is also inappropriate because "constructive fraud" is confusing, and what is deemed actual fraud (under subsection 4(a)(1)), does not actually require proof of fraudulent intent. See UVTA, §4, cmt. 10 (2014).

Confusion caused some courts seeking collection to latch on to the word "fraudulent." This led to applications of UFTA inconsistent with its original intent. Some courts applied and continue to apply higher (fraud) pleading standards, and higher evidentiary burdens. The application of a heightened pleading standard most commonly occurs in Bankruptcy Courts applying the Federal Rules of Civil Procedure. For instance in In re: Sharp Int'l Corp, the second circuit, in affirming a decision by a bankruptcy court, held that when

> *"actual intent to defraud creditors is proven, the conveyance will be set aside regardless of the adequacy of consideration given." McCombs, 30 F.3d at 328. As "actual intent to hinder, delay, or defraud" constitutes fraud, Atlanta Shipping, 818 F.2d at 251, it must be pled with specificity, as required by Fed.R.Civ.P. 9(b). Moreover, "[t]he burden of proving 'actual intent' is on the party seeking to set aside the conveyance." In re Sharp Int'l Corp., 043 f.3d 43, 56 (2d. Cir 2005) (citations omitted).*

The court's imposition of a heightened pleading standard reflects how the court confused the creditor's remedy of avoidance with the elements of common-law fraud. A higher pleading standard improperly limits creditor claims.

The confusion has also led several courts to impose a higher evidentiary burden than was intended by the UFTA. The California Sixth District the UFTA "preponderance of the evidence" standard.

Court of Appeals held in Reddy v. Gonzalez that, to avoid a transfer, a creditor must prove the actual intent to hinder, delay, or defraud "by clear and convincing evidence." Reddy v. Gonzales, 8 Cal. App 4th 118, 123 (1992); see also Parker v. Parker, 681 N.W.2d 735, 7432 (Neb. 2004) (court applied "clear and convincing" standard to the fraudulent transfer claim under the section of the Nebraska statute that correlates to UFTA section 4(a)(1)). The imposition of a higher standard hinders creditors who would otherwise have a valid claim of avoidance under under the UFTA "preponderance of the evidence" standard.

The change in terminology itself is not designed to have any substantive impact. The Commission states in the preface that "[n]o change in meaning is intended". UVTA, Prefatory Note (2014). However, the change seems motivated by the Commission's desire to deter the misinterpretation of "shorthand tag[s]" "constructive fraud" and "actual fraud." UVTA §4, cmt. 1 (2014). In addition, the change in terminology is aimed at reducing the confusion caused by the word "fraud" in applying UFTA. See U.V.T.A. §4, Comment 8. The Commission handled some of these issues directly and indirectly. They did so, by adding new subsections and amending and adding comments.

Defining the Party that Bears the Burden of Proof

The Commission took direct measures to correct the differing evidentiary standards, and burdens of proof. For example, some courts have applied the "clear and convincing" evidence standard to actions under UFTA subsection 4(a), instead of the "preponderance of the evidence" standard that was intended. The Commission added the subsections 2(b),4(c),5(c),8(g), and 8(h) which together create "uniform rules on burdens and standards of proof relating to the operation of the [UVTA]." UVTA §4, cmt. 10 (2014). If adopted by the states, these additions will create the intended uniformity in application. Adoption will also create more certainty for creditors (no longer subject to higher evidentiary standards in jurisdictions that adopt the UVTA). The following is an overview of such subsections.

Subsection 2(b) deals with the presumption of insolvency. It states:

> *" a debtor that is generally not paying the debtor's debts as they become due, other than as a result of a bona fide dispute, is presumed to be insolvent. The presumption imposes on the party against which the presumption is directed the burden of proving that the nonexistence of insolvency is more probable than its existence". (emphasis added) UVTA §2(b) (2014).*

This subsection revises the UFTA in two ways. First, it clarifies that debts subject to "a bona fide dispute" are not to be considered when determining whether the debtor is failing to pay his debts as they become due. Id. Second, the statute places on the debtor the burden of rebutting the presumption of insolvency by proving the "nonexistence of insolvency is more probable than its existence." Id.

The addition of the "bona fide debts" language is simply a matter of clarification, as this was "the intended meaning of the language before the… [UVTA]". UVTA §2(b), cmt. 2 (2014). This also brings the definition of insolvent in subsection 2(b) in line with that of the Universal Commercial Code (UCC), and the Bankruptcy Code. Id.

UVTA subsection 4(c) is another new addition. It provides the evidentiary standard for a claim under section 4 "TRANSFER OR OBLIGATION VOIDABLE AS TO PRESENT OR FUTURE CREDITORS," and defines the party that bears the burden of proof under the section. The significance is similar to that of subsection 2(b). The addition is designed to clarify the act and prevent disparate interpretations. In states that apply the evidentiary standard of "clear and convincing evidence", adoption of this provision would change the evidentiary standard to "preponderance of the evidence" standard. UVTA §4(c) (2014). The effect, in those jurisdictions, would be to make it easier for creditors to proceed with claims for avoidance under UVTA section 4. In addition, it is likely that heightened pleading standards would no longer be applied in states that adopt the UVTA for claims under section 4. UVTA subsection 5(c) provides the evidentiary standard and allocates the burden of proof for a claim under UVTA section 5 "TRANSFER OF OBLIGATION VOIDABLE AS TO PRESENT CREDITORS."

UVTA Subsection 5(c) places the burden proof on the creditor, except to the extent the burden is limited by subsection 2(b) (which shifts the burden to the debtor to show they are not insolvent if a creditor has proven the debtor is not paying his debts as they become due). UVTA §5(c) (2014). Subsection 5(c) establishes the evidentiary standard as a preponderance of the evidence. Id. Defining which party bears the burden of proof is likely most significant when added to this section because judicial presumptions have been applied that shift the burden to the transferee to show section 5 is inapplicable. For example, in In Re M. Fabrikant & Sons, Inc., the bankruptcy court applying New York's UFCA stated that New York law "presumes that the debtor who transfers property without fair consideration is insolvent, and the burden shifts to the transferee to rebut it." In Re M. Fabrikant & Sons, Inc. 447 B.R. 170, 195 (2011). The addition of subsection 5(c), and its brethren should override judicial presumptions such as those in In Re M. Fabrikant & Sons, Inc.

Subsection §8(g) was added to the UVTA to establish the party with the burden of proving each subsection of section 8 "Defenses, Liability, and Protection of Transferee or Obligee." The party asserting one of the following defenses bears the burden of proving its applicability:

1) That a transfer is not voidable under subsection 4(a)(1) because the transferee took in good faith and for reasonably equivalent value to the debtor.

2) A good faith transferee or oblige is entitled, to the extent of the value given to the debtor, to a lien or a right to retain an interest in the asset transferred, an enforcement of an obligation incurred, or a reduction in the amount of the judgment.

3) A transfer is not voidable by subsection 4(a)(2) or subsection 5 if the transfer results from the termination of a lease upon default by the debtor, or it is an enforcement of a security interest in compliance with article 9 of the UCC, except if the acceptance of the collateral is in full or partial satisfaction of the obligation it secures; or

4) A transfer is not voidable under subsection 5(b) to the extent (i) the insider gave new value to or for the benefit of the debtor after the transfer was made (except to the extent the new value was secured by a lien), (ii) it was made in the ordinary course of business of the debtor and the insider, or (iii) it was made pursuant to a good-faith attempt to rehabilitate the debtor and the transfer secured present value given for that purpose as well as an antecedent debt. UVTA §8 (2014).

Under section 8, a creditor carries the burden of proving that the transfer is avoidable under subsection 7(a)(1). UVTA §8(b) (2014). By proving a transfer is avoidable under subsection 7(a)(1), a creditor may recover the value of the asset transferred or the amount necessary to satisfy the creditor's claims. UVTA §7(a) (2014).

"...fraudulent and voidable are used inconsistently to refer to transactions for which the act provided a remedy."

Subsection 8(b) provides a defense to an avoidance action for an "immediate or mediate transferee of the first transferee" if they took in good faith and for value. UVTA §8(b)(1). Subsection 8(b) also provides a defense to a person who took in good faith that is a subsequent transferee of a person that took in good faith and for value. Id. A party raising either of these defenses carries the burden of proof. UVTA §8(g)(3). A party seeking adjustment to the value of the asset based "on the equities" of the transfer subject to avoidance has the burden of proving the equities. UVTA §8(c) (2014).

These subsections (like the other additions allocating the burden) are not designed to enact substantial change, but instead to clarify the law as originally intended by the UFTA. The defined burdens of proof will likely curb judicially crafted presumptions, and create more predictability when an action is brought under the UVTA. See UVTA, §4, cmt. 11 (2014).

The final addition to subsection 8(h), provides the evidentiary standard for all of section 8. UVTA §8(h) (2014). Consistent with the rest of the UVTA, it applies the "preponderance of the evidence" standard. Id.

Shifting the Focus from "Fraud" in Section 4(a)(1) Avoidance Actions

As stated above, the UVTA Commission was concerned about the misapplication of the act caused by the word "fraud". The focus on "fraud" was primarily by courts applying the test under subsection 4(a)(1). Under subsection 4(a)(1), to determine if a transfer or obligation is avoidable, a court must determine whether the transfer or obligation was made with "actual intent to hinder, delay, or defraud a creditor." UVTA §4(a)(1) (2014). Oftentimes the focus devolved to whether there was an "actual intent" to "defraud." See General Electric Corp. v. Chuly Int'., LLC, 1, 4 (Fla. App. 2013), ("Because the determination of actual fraudulent intent can be difficult, courts look to certain 'badges of fraud' to determine whether the transfer was made with the intent to defraud creditors.") (emphasis added). As noted, courts continue to confuse fraudulent transfer with common law fraud. The Commission sought to clarify how subsection 4(a)(1) should be applied, by the addition of a comment to section 4.

In the comment, the Commission emphasizes that the phrase "hinder, delay, or defraud" is a term of art. UVTA §4, cmt. 8 (2014). It should be applied as a whole, and not parsed out, nor should the focus solely be on "defraud." The inquiry is not to be left to the subjective intent of the debtor. See In re Sentinel Management Group Inc., 728 F3d. 660 (7th Cir. 2013). Instead, whether a debtor is found to actually "hinder, delay, or defraud" a creditor depends upon whether "the transaction unacceptably contravenes norms of creditor's rights." UVTA §4, cmt. 8 (2014). Such norms are to be analyzed in light of "the devices legislators and courts have allowed debtors that may interfere with those rights." Id.

This comment has the potential to properly recast the analysis courts conduct when weighing the so-called "badges of fraud" of subsection 4(b). The Comment appears to propose a test for determining whether there has been an attempt to "hinder, delay, or defraud". The proposed test is whether the conduct "contravenes norms of creditor's rights", broadening the test which had devolved, in some cases, to whether the conduct was to defraud. UVTA §4, cmt. 8 (2014). In addition, emphasis on debtor conduct should minimize focus on the malicious intent of the debtor. The comment also cautions against avoiding transfers of legal means, such as transfers to a self-settled spendthrift trust which is permissible in some states. Such transfers should not be avoided in all cases because statutory authorization supplants what would otherwise almost always be an avoidable transfer.

"The Comment appears to propose a test for determining whether there has been an attempt to 'hinder, delay, or defraud.'"

Choice of Law

The driving force behind the revision of the UFTA appears to be the inclusion of a choice of law rule, which has the potential to eliminate much of the litigation in an avoidance action. The new choice of law rule is embodied in section 10 of the UVTA. The rule is similar to that of the UCC. See UVTA §10. Cmt 1 (2014). UVTA section 10 utilizes the debtor's location to determine the local law that governs the avoidance action. UVTA §19)b) (2014). The test is the debtor's location at the time of the transfer or incurrence of the obligation. Id. The debtor's location is defined as:

1) *The debtor's principal residence if the debtor is an individual.*

2) The debtor's place of business if the debtor is an organization and has one place of business, or .

3) The debtor's chief executive office if the debtor is an organization and has more than one place of business. UVTA §10(b) (2014).

The rule is simple, clear and easily applicable. The choice of law can have profound consequences. For instance, even among states that enacted the UFTA there are variations in the statute of limitations period, the treatment of an insider transfer, and the treatment of foreclosure sales and other involuntary transfers, among others. The choice of law rule does not alter these changes, and some are likely to persist. Instead, it affords creditors predictability as to which law will govern an avoidance action.

The significance of the rule is magnified when analyzing an example of a possible avoidable transfer. Absent a choice of law rule, it is difficult to determine which law will apply in the following scenario. A creditor located in California extends credit to a debtor individual residing in Florida. .

If the court hearing this action determines that Florida law is applicable, the transferee may have a defense that the transfer is exempt from avoidance because Florida has a provision in its version of the UFTA which exempts some contributions to charity from avoidance. Fla. Stat. 726.109(7) (2013).

The other three states California, Georgia, and Alabama do not have this exception. Assuming that the charity exception in Florida applies, the creditor would have a strong interest in trying to invoke the laws of one of the other jurisdictions with a connection to the transfer.

Under this scenario, a jurisdictions operating under the First Restatement of Conflict of Laws would apply the "situs" rule. The "situs" rule provides that the governing law is the law of the state where the asset was located, when it was transferred. This rule is rarely followed, and now most courts apply the Second Restatement to an avoidance of a transfer. The Second Restatement approach for Torts is to analyze the conflicting interests of the jurisdictions. The Second Restatement takes into account four different forms of contact, and seven different factors. The existence alone of a total of 11 variables (none of which is afforded any particular weight), determine which jurisdiction has the most interest in having its law be determinative in the dispute. Second Restatement, Conflict of Laws §145. This, by its very nature, is unpredictable and invariably leads to disparate results in different jurisdictions (or the same jurisdiction). Therefore, under the Second Restatement it is not possible to know which State's law would be applied. If section 10 of the UVTA is applied, the answer is clear. The applicable law is Florida law.

The UVTA improves on both the Second Restatement and the First Restatement in two respects. First, it creates clarity for the creditor. The Second Restatement creates uncertainty for the creditor because it cannot be known before litigation which law will apply. This makes it more difficult for the creditor to gage the risk when extending credit. Second, section 10 of the UVTA does not appear to be as subject to abuse or manipulation (as is the "situs" rule of the First Restatement). An asset, particularly an intangible asset, or chattel, could be moved prior to the transfer to take advantage of more favorable fraudulent transfer law. Section 10 does a better job of preventing abuse by using more certain locations which are more difficult to manipulate.

Section 10 of the UVTA is not, however, immune to abuse. For example, an organization with multiple places of business could potentially manipulate the location of its chief executive office, or a business or resident could move prior to making the transfer. However, courts are able to look beyond the nominal place of residence, or chief executive office, and determine the true location based on activities of the debtor UVTA §10, cmt. 3 (2014). The Commission states that a court should not fall suspect.

for an artificial location which has been achieved by manipulation. Instead the courts should look to "authentic and sustained activity". Id.

Section 10 has the ability to diffuse disputes over the choice of law and give more certainty to creditors when extending credit. Note that it will, however, not alter the uncertainty of the choice of law in a Bankruptcy proceeding. In determining applicable state law, Bankruptcy Courts often take one of three approaches: (i) apply the choice of law created by federal common law, (ii) apply a uniform choice of law rule of the state in which they site, or (iii) apply the choice of law rule of the state in which they sit unless a federal interest requires the use of the federal choice of law rule. Section 10 cannot remedy this, as it is only applicable to state law (where adopted).

"The rule is simple, clear and easily applicable. The choice of law can have profound consequences."

Other Changes Adopted in the UVTA

A. *§8(e)(2) Removing Strict Foreclosures from The Exemption for Article 9 Security Interests.*

There were a few other minor changes to the UVTA. The first one, of some significance, is the alteration of subsection 8(e)(2) which exempts transfers from avoidance, if the transfer is made pursuant to the enforcement of a security interest made in compliance with UCC Article 9. The Commission added a new clause to subsection 8(e)(2). The new clause excludes from such exemption transfers made pursuant to an Article 9 security interest when the creditor accepts collateral for partial or full satisfaction of the obligation it secures. UVTA §8(e)(2). This means that §8(e)(2) no longer gives an exemption to strict foreclosures of Article 9 security interests. The significance is that creditors with an Article 9 security interest can no longer foreclose on the property and retain it, without risking the transfer being avoided. The creditor can, however, still conduct a foreclosure sale under Article 9 and be immunized from the transfer being avoided.

Under UFTA subsection 8(e)(2), there was no protection afforded other creditors from a creditor with an Article 9 security interest that foreclosed on an asset with built-in equity, and retained the asset. Remaining equity in the asset would have otherwise been available to settle other debts. Now, a creditor with an Article 9 security interest that forecloses may retain the asset, but be left subject to avoidance, or they must conduct a sale of the asset in a "good faith" and "commercially reasonable manner." See UCC Art. 9 (2014). Both of these scenarios should protect the equity in the asset for other creditors.

B. Deletion of a the Separate Definition of Insolvency for a Partnership.

Subsection 2(c) of the UFTA provides a separate definition for partnership insolvency. Insolvency of a partnership under this subsection is measured by determining if the sum of all of the partnership's debts is greater than the aggregate of the partnership's assets and the value of the general partners' non-partnership assets to the extent they exceed the partners' non-partnership debt. The Commission deleted UFTA subsection 2(c) to treat partnerships the same as other debtors. The deletion of this provision now treats partnerships the same as other debtors. This deletion is significant because, when determining partnership insolvency, partnerships may not take into account assets to which the partnership may not have access. Modern business entity statutes permit partnerships to be formed where a (limited) general partner is not personally liable for all or even part of the partnership debts. Assets of general partners not liable for all partnership debts should not count in the solvency determination of the partnership (to prevent insolvency and avoidance of a transfer by the partnership).

The Commission found no reason to retain a rule that effectively gave special treatment to partnerships. See UVTA Prefatory Note (2014). The Commission viewed the liability of a general partner similar to that of a guarantor of a non-partnership debtor because both debts are guaranteed by contract. As a result, there did not seem to be any reason to define insolvency differently for a partnership debtor from that of a non-partnership debtor.

C. Series Organization.

The UVTA adds a new section, section 11, which extends the application of fraudulent transfer law to series organizations and the series that comprise them. UVTA §11 (2014). The new section goes to great length to define a series organization, and a protected series. It defines a protected series as an arrangement by a series organization that has the same characteristics as a series organization. UVTA §11(a) (2014). A series organization is an organization that has the following characteristics:

1) An organic record of the organization which provides for the creation of one or more protected series with respect to specified property of the organization, and provides for records to be maintained for each protected series., the records of which identify the property of or associated with the protected series.

2) The debt incurred or existing with respect to the activities or property of a particular protected series is enforceable against only the property of or associated with the protected series, and not against other property of or associated with the organization or other protected series of the organization.

3) The debt incurred or existing with respect to the activities or property of the organization is only enforceable against the property of the organization and not against the property of or associated with a protected series of the organization. Id.

The act treats each series organization, and each protected series of the organization, as a separate person, regardless of whether they would be treated as separate persons under other areas of the law. UVTA §11(b) (2014). The act extends to series organizations and protected series, "however denominated", if they meet the characteristics set forth in the UVTA. Id.

This addition (segregating valuable assets between series, to potentially void such transfers and restrict avoidance of insolvency) may become quite significant, if adopted in states where series organizations (or Series LLCs) are permitted by statute. However, the UVTA arguably treats series as they would have been treated under the UFTA, since each series is ordinarily treated as a separate entity by statute. Nevertheless, the revisions ensure that transfers between series, or a series and the organization can be avoided.

D. Modernizing the UFTA.

There are a few other changes made to UFTA which are of note, but likely have no practical significance. The first is the change in the title. The Commission approved the change of "transfer" to "transaction". UVTA §14 (2014). The Commission made the change to make the title more inclusive. UVTA § 14, cmt. 1 (2014). "Transfer" ignored obligations which are also covered by avoidance law. Id. Second, the Commission took steps to modernize the UFTA, by adopting the terms "electronic" and "record" in place of writing. UVTA §1 (2014). These changes create medium neutrality by incorporating almost any mode of communication which more accurately reflects the manner in which business is conducted today. Third, the definition of "organization" was changed to conform to the UCCs definition; it is now separate from the definition of a person. See UVTA, §1 cmt. 10 (2014). An organization is now any person other than an individual. UVTA §1(10) (2014). The definition of "person" has been changed to remove the word "organization," but is fundamentally the same. UVTA §1(11) (2014).

Summary

UVTA made several improvements to the UFTA. Some of the changes are more significant than others. The inclusion of a choice of law rule at section 10 will limit litigation and likely create a more stable lending environment. The removal of the exclusion from avoidance for Article 9 strict foreclosures also provides needed clarity. The clarification of burdens of proof and evidentiary standards will reduce the improper imposition of common-law fraud standards in avoidance actions. The change of "fraudulent" to "voidable" will also reduce confusion among the courts when applying the UFTA/UVTA. The other minor changes to the language of the UFTA modernize the Act and bring it in line with other uniform laws and the Bankruptcy Code. Overall, the changes are a positive step.

"...as the successor to the Uniform Fraudulent Transfer Act (UFTA). UFTA was itself an update of its predecessor, the Uniform Fraudulent Conveyance Act (UFCA)."

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"Many states are aggressively positioning to collect sales and use taxes from e-commerce and remote sellers. Business owners that aren't prepared may be in for quite an unpleasant surprise as they begin to receive tax due notices from state taxing authorities."

– Kathryn Jones

It's a Jungle Out There: A practical overview of so-called "Amazon" laws

By: Kathryn P. Jones

Published in the *Orlando Business Journal*

Given the remarkably rapid rise of internet commerce, it is no surprise that cash-strapped states are looking for ways to tap into (i.e., tax) the bountiful stream of internet commerce. To do so, states will expand the "nexus" of their taxing authority to reach online sales.

Nexus is a basic constitutional limitation on each state's ability to require a "remote" seller (i.e., a seller located outside of the state) to collect and remit sales and use tax on sales made within such state. Nexus generally means the minimum level of contact a remote seller must have with a state before such state can legally require the taxpayer to collect sales and use taxes.

The U.S. Supreme Court has ruled that the Commerce Clause requires "substantial nexus" to any state (outside the seller's primary residence) before any such state may force a seller to collect sales and use taxes. Courts traditionally defined "substantial nexus" in terms of physical contact (i.e. direct in-state presence). Activities that clearly fit within this traditional definition may include:

- Employing or sending a sales person to a nonresident state;
- Having a local phone number in the nonresident state that is forwarded to headquarters located in the resident state;
- Maintaining a P.O. Box in a nonresident state;
- Installing or delivering products in a nonresident state;
- Attending a trade show in a nonresident state, and having sales in that state; or
- Hiring independent contractors in the nonresident state to provide warranty services on property sold in that state.

The explosion of internet sales and the rapidly advancing technology that makes it easier for remote sellers to sell into a state (without any physical contact or engaging in any of the activities listed above) makes it increasingly difficult to apply traditional concepts of nexus in the world of e-commerce. From the taxing state's perspective, such difficulty translates into lost sales and use tax revenue.

A number of states have therefore passed so-called "Amazon" or "click through nexus" laws, in an attempt to cast a wider net on the types of activities that create "substantial nexus" to a particular jurisdiction. Generally, such laws create a presumption of nexus for out-of-state sellers that compensate in-state residents for sales made via links on their (in state) websites. Some states further establish a threshold minimum amount of sales that the remote seller must make before the nexus provisions presumptively apply, and provide whether that nexus presumption is rebuttable or irrebuttable.

Depending on the state, certain internet activities could create "substantial nexus", triggering an internet seller's obligation to collect sales and use tax in the non-resident state (provided that any applicable minimum sales thresholds are met). For instance, substantial nexus could potentially be created if an internet seller:

- Maintains a web link to a third party in the non-resident state;
- Has a "per impression" agreement with a company located in the non-resident state;
- Has a "per impression" or "per conversion" agreement with a company located in the non-resident state;
- Owns an internet server in the non-resident state;
- Leases a third-party's internet server, either exclusively or as a shared use of server space; or
- Has paid webhosting with a server located in the non-resident state.

In light of the fact that sales and use taxes are a creature of state (rather than federal) law, the nexus laws vary from state-to-state, creating additional complexity. For instance, some states, like California and New York, provide that substantial nexus is not created merely by "advertising" online. Other states, like Connecticut, have established an irrebuttable presumption in finding nexus if a remote seller makes more

than $2,000 in in-state sales within a span of four consecutive quarterly periods, if such sales are made through an agreement where the remote seller pays a person located in Connecticut a commission or other sales-based compensation for referring (directly or indirectly, via website link or otherwise) potential customers to the remote seller. Additionally, as sales and use taxes are typically charged primarily on "tangible personal property", the definition of "tangible personal property" varies state-by-state, resulting in inconsistency in whether, for example, digital products are subject to sales tax. From the internet retailer's perspective, state law variations create a seemingly endless web of confusion and potential traps for the unwary.

The Streamlined Sales Tax Initiative ("SSTI") represents an effort by revenue departments of various states to create uniformity among sales tax systems. Under the SSTI regime, a remote seller volunteers to pay sales tax in return for participating in a sales tax regime with uniform provisions intended to facilitate compliance. Such uniform provisions are codified in the Streamlined Sales and Use Tax Agreement (the "SSUTA"). However, not all states are members of the SSUTA and some member states have only adopted portions of the SSUTA. Further, the SSUTA contains only the "model" provisions – individual states statutes continue to control the particular state's tax system, leaving the door open to variation even in member states.

Much has changed in the more than 200 years which have passed since Benjamin Franklin coined the oft-quoted phrase: "In this world, nothing can be said to be certain, except death and taxes." So much so that, in our modern landscape of e-commerce and sales taxes, the world seems anything but certain. For merchants engaged in e-commerce, and their advisors, the importance of thoroughly evaluating these issues and staying up to speed on this rapidly changing area of law cannot be overlooked.

Asset Protection and Entity Selection - Picking the Right Jurisdiction

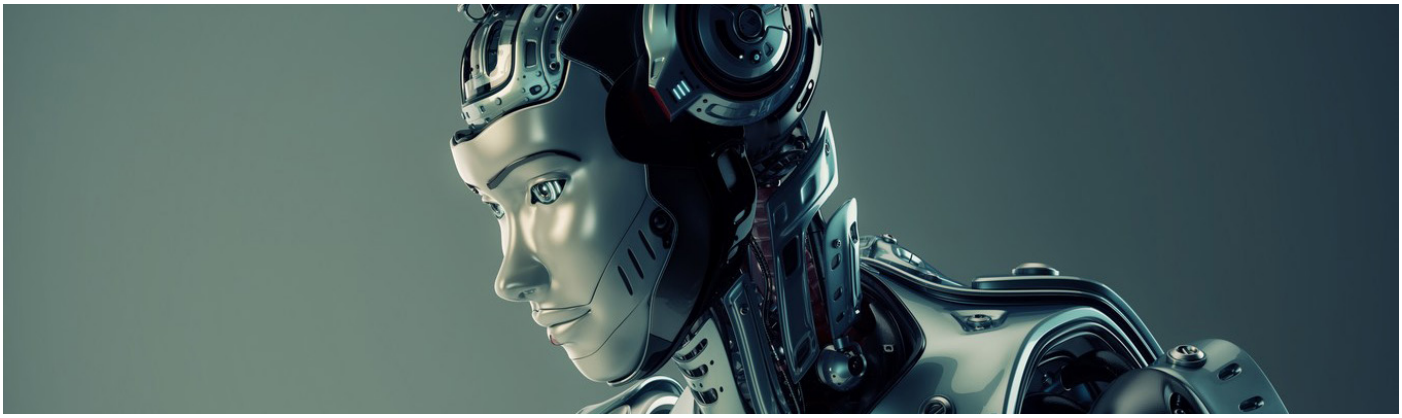
By: Gary Forster and Eric Boughman

Published in *Accounting Today*

Limited liability companies ("LLCs") have become the entity of choice for small business owners and are commonly utilized by professionals in asset protection planning. Choosing to use the LLC over (for example) a corporation may be prudent but raises the question of where to form the LLC. There are several factors to consider in deciding where to establish the entity. Picking right LLC jurisdiction may be as important as the decision to use an LLC.

In 2010, the Florida Supreme Court issued a ruling that eviscerated the effectiveness of the Florida single-member LLC for asset protection purposes. In Olmstead v. FTC, the Florida Court, using judicial acrobatics, ruled that a judgment creditor may foreclose the LLC membership interest of the debtor. Although the writing was already on the wall - after all, other court decisions had previously called into question the wealth protection effectiveness of the single-member LLC - the Olmstead decision sent many Florida planners scrambling for safety in other states. States such as Nevada, Alaska, and Wyoming provide express statutory language respecting the protection of single-member LLCs. Wyoming became a particular favorite because of its low cost and the fact that LLC members and managers were not required to be publicly disclosed. A recent decision by the Supreme Court of Wyoming, however, should give planners cause for concern. In *Greenhunter Energy, Inc. v. Western Ecosystems Technology, Inc.* The Wyoming Supreme Court upheld a ruling that permitted the creditor of a corporation's wholly owned subsidiary to "pierce the corporate veil" of the subsidiary, making the parent company responsible for the debts of its subsidiary. Veil piercing is an extraordinary remedy typically reserved for those cases involving fraudulent conduct. The remedy is rarely permitted unless a limited liability entity is found to be the mere "alter ego" of its owner such that it would be inequitable not to make the owner responsible for subsidiary's debts. In Greenhunter, the Wyoming Supreme Court acknowledged that the two companies (parent and subsidiary) maintained separate bank accounts and business records. The court, however, took the unprecedented step of considering consolidated tax returns as a factor favoring the alter ego relationship and permitted the plaintiff to pierce the subsidiary (to reach the parent's assets).

The Wyoming Supreme Court's decision to confound tax treatment with legal liability is unprecedented and runs counter to proper application of LLC protections. This is a dangerous and surprising prospect from a state otherwise offering one of the most protective LLC statutes in the country. The ruling forces us to consider dropping Wyoming as an option for LLC formation.



Other factors should be considered as well. If stability is a concern, Delaware is a traditional choice and Nevada offers a sound alternative due to its reliance on Delaware's long-standing body of favorable corporate law. If privacy is a concern, Delaware and Alaska are options. If the entity is to be owned by a single member and charging order protection is a concern, Nevada and Alaska offer sound legal framework. If maximum asset protection is desired, the best options are often offshore. And, finally, one should always consider the types of assets to be owned by the LLC.

It makes little sense, for instance, to use a Delaware LLC to house Florida real estate for asset protection. The practical reality is that any litigation involving the property is likely to occur in Florida, where a Florida court could be expected to apply Florida law.

Entity selection is a fluid process. As reflected by the recent Wyoming decision, the Supreme Court of a favored state can quickly throw the state's law into a tailspin. Professional planning requires constant study and an awareness of legal trends and pitfalls.

"IRS rules allow for a single-member LLC to be taxed as a disregarded entity. Indeed, the principal advantage of single-member LLCs has been their recognition as offering greater limited liability benefits than a corporation, coupled with 'disregarded' tax treatment (avoiding the need for a tax return)."

Delaware Bank Accounts For Asset Protection – Not A Silver Bullet

By: Eric Boughman and Gary Forster

Published in *Accounting Today*

As the story goes, John D. Rockefeller was getting his shoes shined when the shoe shine boy, not knowing whose shoes he was shining, started offering stock tips. That was Rockefeller's cue to turn bearish on the stock market. "Secret" tips lose their efficacy when no longer secret.

While speaking at a recent seminar, we received several questions from CPAs and Financial Professionals about the use of Delaware bank accounts to protect cash. The questions reflect a national trend to use Delaware accounts for "asset protection." Delaware law exempts banks and other financial institutions in Delaware from attachment and garnishment. Attempts by creditors to circumvent the law have been met with resistance in Delaware. In one case, a judgment creditor who apparently understood. that garnishment was prohibited against banks, tried to freeze a debtor's Delaware account by seeking a temporary restraining order prohibiting the bank from releasing funds.

The Court considered the order the functional equivalent of a garnishment and denied the request. The Court explained that any order restricting the bank from releasing funds would violate Delaware's "clear legislative policy exempting banks from garnishment." For desperate debtors subject to a collection action, keeping cash in a Although Delaware banks are exempt from garnishment, nothing prevents a motivated and well-funded judgment creditor from issuing a subpoena to discover information regarding a debtor's deposits (even knowing they can't be garnished). A judge outside of Delaware, but with the debtor sitting in his court and intending to see a judgment enforced, may enter an order directed toward the debtor that practically eviscerates the effectiveness of the Delaware restriction. This is precisely what happened in one recent case in the Federal District Court in Orlando, Florida.

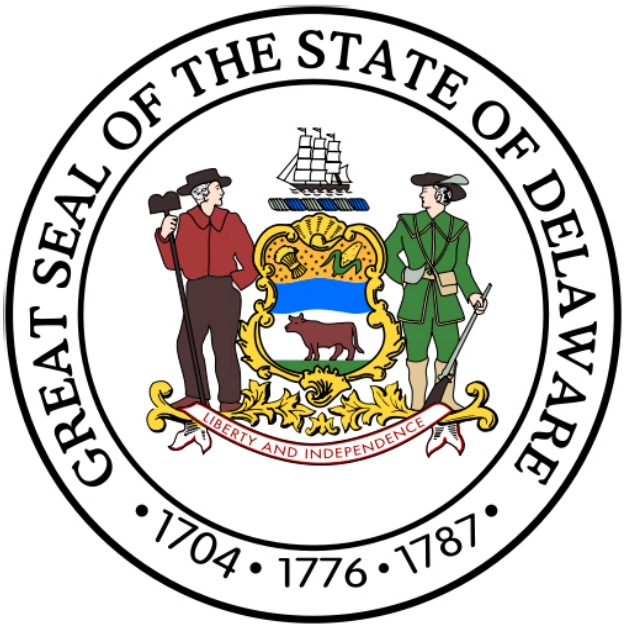
In Travelers Casualty and Surety Company of America v Design Build Engineers & Contractors Corp. et al., a judge ordered a defendant with a well-funded Delaware bank account (but, presumably, little other exposed assets) to post a cash bond with the Court as collateral while a lawsuit was pending over certain indemnity agreements.

The facts of the case were the type likely to draw ire from the judge. Travelers sold a surety bond sold to Design Build Engineers and Contractors Corp. Who, subsequently, got into a dispute over performance of two construction contracts insured by the bond. Travelers ultimately paid nearly $1.5 Million to settle the two claims. Under certain indemnity agreements executed in connection with the bond, Design Build's principals, Mr. and Mrs. Thompson, were required to deposit collateral with Travelers to cover the losses. When they failed to do so, Travelers sued. Then it got interesting.

Facing the lawsuit, the Thompsons formed several LLCs into which they transferred certain properties. Transfers of this type are the reason fraudulent transfer laws exist. Once transferred, two of the properties were sold for about $1 Million and the proceeds were used to pay down the Thompsons. Florida home mortgage. The Thompsons kept all the leftover cash in a Delaware bank account. Travelers sought an injunction requiring the Thompsons to post collateral as required by the indemnity agreements.

The Thompsons' attorney made the right arguments. First, injunction is an extraordinary remedy intended to prevent irreparable harm that cannot be repaired with money damages. Though unpleasant, the mere loss of money can be remedied by a money judgment and is not recognized, in the legal context, as irreparable harm. Indeed, requiring a party to deposit money with the court would appear to be precisely the type of relief not permitted by an injunction. Additionally, the U.S.

"The effectiveness of asset protection planning is highly dependent upon timing."



Supreme Court has stated that (unsecured) creditors generally may not freeze assets prior to entry of a judgment. The Thompsons may also have argued that the court had no jurisdiction over the Delaware accounts and could not enter an order with respect to those accounts.

In any event, the Court was not persuaded and ordered the Thompsons to post a collateral bond with the court amounting to nearly $1.5 Million. In doing so, the Court said: "While posting bond may be unpleasant to the Defendants, they will not be harmed by the requirement that they abide by the terms of their agreement." The ruling stretches the boundaries of applicable law. Although Travelers was entitled to demand collateral under the contract, once the Thompsons failed to comply, the contract remained, on its face, an unsecured contract for money damages.

A prejudgment injunction should not be used to magically transform an unsecured contract into one that is collateralized based solely on a claimed breach; otherwise, every contract for money damages may potentially be transformed into one where the posting of cash security is deemed to be fair and equitable relief. The practical effect of the order places the Thompsons in a precarious position. They can rely on Delaware's unique garnishment restriction (coupled with Florida's constitutional homestead protection) to protect their home and cash from being taken directly; however, if they fail to voluntarily make those assets available as collateral, they risk being held in contempt of court. With contempt can come all sorts of horribles such as fines and incarceration.

The moral of this story is that reactionary transfers intended to desperately protect assets provide a platform for a court to order extreme remedies. As the Travelers court explained, the basis for the order was "supported by Defendant's efforts to shield assets from Travelers' lien claims by transferring assets to LLCs controlled by the Defendants." Clearly, the court was not impressed with the Thompsons' twelfth-hour transfers.

Would the result have been different had the Thompsons engaged in the same protective transfers two years before the start of the lawsuit, instead of two weeks after? We think so. The effectiveness of asset-protection planning is highly dependent upon timing. And, as the Travelers case shows, gambits like reliance upon Delaware's now-popular banking statutes or Florida's ultra-protective homestead laws pale in protective comparison to well-conceived protective planning.

"Data and privacy are among our most fundamental and precious assets. We expect that policies relating to the capture, use, and sharing of data by artificial intelligence systems will be among the most predominant legal issues of the next several years."

-Eric Boughman

Practical Considerations for Using Self-Settled Trusts

By: Eric Boughman

Published in *Forbes*

Is it any surprise that Donald Trump, now our President-elect, may have strategically manipulated the tax code to avoid paying federal income tax? Mr. Trump calls this "smart" and many in the same boat would agree. Similarly, sophisticated clients and advisors implement legal tactics to prudently preserve and protect wealth. One strategy growing in popularity is the "self-settled" trust for asset protection.

Under traditional trust law, a grantor conveys assets to a trustee, for the benefit of someone else, such as his children. The gift "divides" ownership between so-called legal title and equitable title. The trustee may legally oversee the assets (pursuant to a trust agreement) benefitting beneficiaries (who have no control over trust assets). Once the assets are in trust, they are generally protected from future creditors of the grantor, trustee (with legal title), and beneficiaries (with equitable title).This splitting of legal and equitable title traditionally shields trust assets from creditors of the (i) trustee, who has no legal right to use or distribute trust assets other than for the benefit of the beneficiaries; or (ii) beneficiaries, who have no legal ability to demand or direct distributions or convey title to trust assets. Traditional trusts typically have a "spendthrift" provision which protects trust assets by restricting the beneficiary from assigning future income or trust assets to creditors (thereby prohibiting a creditor of a beneficiary from attaching trust income or assets). The traditional trust, for instance, allows parents and others to make protected gifts to children.

Self-settled trusts are distinct in that they are funded by a grantor who retains the benefit of trust assets. Only legal title is conveyed to a third party trustee to put trust assets (theoretically) outside the reach of creditors. Several offshore jurisdictions and 17 US States have enacted statutes permitting such arrangement. In these jurisdictions, the grantor may 'have his cake (protection) and eat it (the assets) too.'

"...sophisticated clients and advisors implement legal tactics to prudently preserve and protect wealth. One strategy growing in popularity is the 'self-settled' trust for asset protection."

The grantor/beneficiary enjoys the fruits of the trust assets but has no legal right to transfer title or direct proceeds to creditors. Self-settled trusts are therefore often referred to as "asset protection trusts."

Domestic asset protection trusts ("DAPTS") may have their place in certain asset protection plans, but they still remain largely untested by the courts. Indeed, several non-DAPT states consider such trusts anathema to public policy. Often overlooked in predicting the effectiveness of an asset protection strategy is giving due consideration to which state's law may ultimately be called upon to test it.

Consider the case of a resident of Washington (which offers no DAPT) who forms a DAPT for his own benefit in Alaska (which does have a statute permitting DAPTs), and names himself as a beneficiary and his son as co-trustee (along with an Alaska trust company). The grantor/beneficiary then proceeds to transfer a significant portion of his assets, including title to financial accounts, automobiles, and real estate interests into the trust.

How effective is this arrangement when creditors come knocking in Washington? The debtor will rightly claim that he technically does not own any of the trust assets, as legal title now resides in the trustee. This is similar to what actually occurred in the case of In re Huber, where the founder of the Alaska trust lost everything due to his failure to consider local law and policy. In Huber, a bankruptcy court in the State of Washington relied on Washington law to essentially disregard a DAPT formed in Alaska.

The court looked to several factors suggesting the trust was a sham. The court cited the fact that the beneficiary did not reside in Alaska, one of the trustees was not in Alaska, and perhaps most importantly (as discussed below), trust asset were not located in Alaska. The court also noted Washington's "strong public policy" against self-settled asset protection trusts. The bankruptcy trustee was therefore entitled to disregard the trust and seize trust assets (as personal assets of the grantor/creditor).

Huber offers insight into the factors to consider in using DAPTs for asset protection planning.

Practically, we learned that keeping trust assets and a trustee in a non-DAPT state exposed trust assets to the local court where the assets were located. Had the assets and trustee resided beyond the reach of the court, only the grantor/beneficiary would have remained in the court's jurisdiction. Without legal title, the beneficiary would have no ability to turnover trust assets to creditors. Thus, we can surmise that leaving assets in a DAPT state (with the trustee), pursuant to a properly drafted trust agreement (limiting beneficiary control over trust assets) would likely have substantially restricted court intervention benefitting creditors.

By focusing merely on technical legalities and failing to recognize the practical ability of a court to reach the trustee and trust assets, the Huber DAPT was never designed to hold up in stormy weather and was thus doomed to fail. Practical considerations, such as the law and policy of the state where a DAPT might ultimately be tested, should always be respected.

The Myth of Using Cryptocurrencies For Asset Protection

By: Eric Boughman

Published in *Forbes*

The Great Recession of the mid-2000s forced us to view economics, banking, wealth, and security in new ways. The concept of asset protection, already a growing area, saw an explosion in popularity which has given rise to an ever-evolving cat and mouse game between creditors and debtors and their respective advisors. Meanwhile, distrust in banks and governments fueled the creation and rise of Bitcoin which, in turn, spurred interest in new digital currencies relying upon similar technologies. Following is a discussion about the technology underlying virtual digital currencies and how it might play a role in asset protection.

Virtual digital currencies (or "cryptocurrencies") operate on decentralized databases called blockchains. Blockchains function as publicly distributed ledgers, verifying and permanently recording asset transfer transactions between buyers and sellers without the need for a trusted third-party. These technological breakthroughs are enabling the new, digitized economy.

Blockchain introduced a technology to solve a longstanding computer science problem, known as the "double-spend" problem, eliminating the potential for an unscrupulous or unknowing buyer to spend the same money more than once. A "trustless" ledger system employs public key cryptography to ensure transaction inputs are not duplicated. There is no need for third-party intermediaries. Transactions are grouped and recorded in blocks, then linked to the last block in the chain.

A system of consensus and cryptography validate each of the transactions. In the Bitcoin protocol, transactions are validated by "miners" who receive Bitcoins as a reward (or premium) for their processing efforts. Once a sufficient consensus of miners has validated the cryptographic hash of a transaction, the information is recorded in a "block." Successive blocks of transaction data are built upon previous blocks to form a chain – hence the name "blockchain."

The process of recording transactions in interconnected blocks creates an immutable, time-stamped ledger which is not subject to manipulation by any person, company, or government.

With the absence of the middle-man, and by existing on a distributed ledger in cyberspace, digital currencies are effectively borderless and can represent stores of value in all parts of the globe. Bitcoin, the most recognized digital currency, is not controlled by any centralized government entity or organization, but instead by willing participants (generally the miners) that build and maintain the chain.

"Successive blocks of transaction data are built upon previous blocks to form a chain – hence the name 'blockchain.'"

Blockchain transactions are semi-anonymous – or "pseudonymous." Each transfer of value on the ledger is publicly viewable, but parties to the transaction are known only by a string of numbers serving as a public key address. (Bitcoin transactions are publicly viewable in real-time at www.blockchain.info.) Anonymous users manipulate ownership and transfer of Bitcoin with their private key, a separate string of numbers, generally kept secret. This ability to engage in transactions pseudonymously (coupled with the absence of intermediaries discussed above) makes Bitcoin the currency of choice for gray and black market transactions. The infamous Silk Road website relied upon Bitcoin payments and, more recently, Bitcoin has become the preferred payment for cyber-criminals such as those engaged in the rising epidemic of cyber-ransom.

The pseudonymous (and borderless) nature of digital currencies inevitably leads to a discussion of using Bitcoin for asset protection. The assumption is that, with anonymity, ownership of cryptocurrencies could be an effective and efficient means to hide wealth. There are a couple of flaws in this assumption, the first of which is the notion of what constitutes legitimate (and defensible) asset protection.

Legitimate asset protection involves strategic planning to protect against unknown, future claims. This point lost on misinformed debtors who seek protection after they've defaulted on a debt, been sued, or face divorce. Reactionary transfers – those made with intent to avoid a creditor – are subject to being unwound by courts as "fraudulent transfers." For maximum effectiveness, implementation of an asset protection plan must begin before creditor clouds start to form.

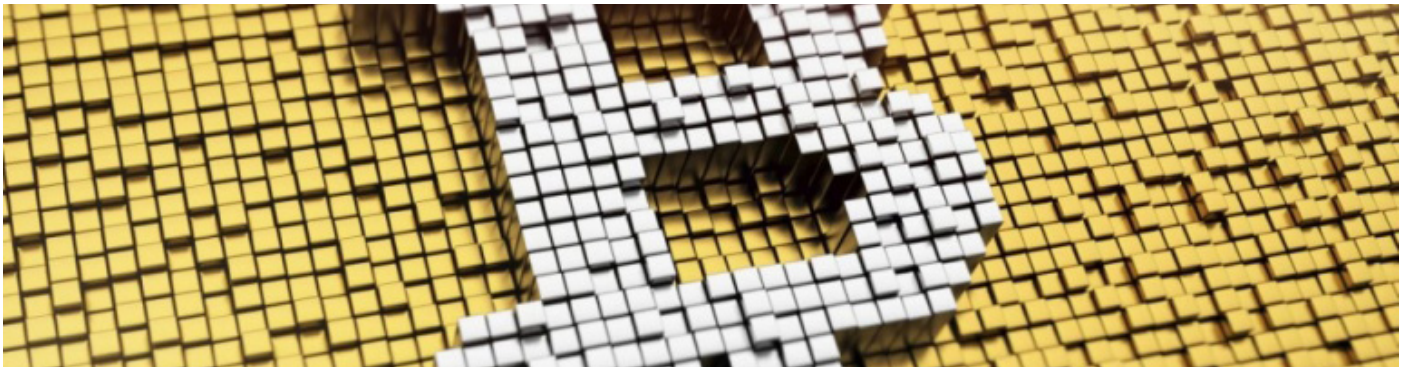
A key but often overlooked element of effective asset protection is transparency. If you are sued and become subject to a money judgment, you will be asked about – and required to disclose – details about your assets, including bank accounts, investments, and real and personal property ownership. Digital currency ownership would be subject to complete disclosure. The inquiry would not be limited to a current snapshot. An effective creditors' lawyer will look at account histories and title chains and scrutinize transfers made during and immediately before a lawsuit to flush out potential fraudulent transfers.

In the digital currency world, transactions are forever documented on the blockchain. The blockchain's immutable, time-stamped ledger renders manipulation of transfer and ownership data practically impossible. Since the timing of transfers is a key component to legitimate asset protection, a blockchain record of transfers can be critical in either validating or undermining the legitimacy of strategic asset transfers.

Could Bitcoin and other digital currencies be useful in asset protection? Sure, but, like cash hidden under a mattress, failure to disclose such ownership may constitute perjury and subject a debtor to contempt proceedings. Using cryptocurrencies with the intention of concealing ownership is not legitimate asset protection. It is simply lying and fraud which can and should lead to harsh consequences.

This is not to suggest cryptocurrencies have not place as one component of legitimate asset protection. In fact, Bitcoin's unique nature, as a store of value existing on a public, immutable, time stamped ledger, coupled with its relative ease of use (particularly across borders) and the high speed at which transactions are settled, offers promise for incorporating cryptocurrency ownership into comprehensive asset protection planning. The intent, however, should not be to hide assets and fly under the radar, but instead to document the occurrence and timing of transactions. In this manner, blockchain transactions might validate legitimate planning with legally defensible transparency.

"The blockchain's immutable, time-stamped ledger renders manipulation of transfer and ownership data practically impossible."



Crypto-Currencies as Legitimate Asset Protection Tools

By: Eric Boughman

Published in *Forbes*

Despite some misconceptions, using bitcoin or other cryptocurrencies for asset protection in connection with offshore planning may be an effective strategy.

A crucial facet to using foreign trusts to protect wealth is ensuring that the trustee and trust assets remain outside of any jurisdiction where the grantor might be sued. Some U.S. states may find the concept of self-settled trusts anathema to public policy and thus choose to ignore the trust and treat the grantor/beneficiary as the de facto owner of trust assets.

Offshore limited liability companies are similarly exposed. Consider, for instance, a Florida resident who forms a Nevis, single-member LLC to shelter assets in a Florida bank account. If that individual is sued, Nevis law limits the judgment creditor's remedy to a lien on LLC proceeds (called a "charging order"). The charging order would not entitle the creditor to take control of the LLC in Nevis. If the creditor were to sue in Florida, however a Florida court might ignore Nevis law (as it would apply to ownership of the LLC) and permit the creditor to foreclose on the LLC interest. As the new owner, the creditor would have direct access to the LLC bank account and any other assets owned by the LLC. Farfetched? This is essentially what happened in Wells Fargo v. Barber.

As highlighted by the Barber case, effective implementation of offshore asset protection requires that assets be transferred to a safe location outside the reach of U.S. courts. Assets must also remain outside the direct control of members and beneficiaries. Courts have mechanisms, via contempt orders, to impose sanctions, fines and jail time to compel a debtor to disclose and turn over assets unless it is truly impossible for the debtor to comply. (While there are colorful examples of jailed debtors under contempt, bona fide impossibility is a valid defense).

Digital Asset Protection

Digital assets, like cryptocurrencies, offer a way to keep assets safely away from potentially hostile U.S. courts because they exist entirely on a decentralized digital ledger known as the blockchain. Cryptocurrency transactions are executed on the blockchain via a two-key system. The keys include an address (public) key and a secret (private) key. Think of the address as a transparent envelope. Anyone can see inside the envelope, but only the secret key can open it to access the contents. Keys are simply a sequence of numbers and letters. The secret key remains under the owner's control and provides the ability to transfer the asset.

"Transfer" is somewhat of a misnomer, as assets don't actually move. Rather, the blockchain ledger is updated to reflect the transfer of ownership. The right to spend digital currency is granted to the holder of the secret key corresponding to the address posted in the blockchain. Additionally, an address can be created to require a combination of multiple secret keys (multiple owners) to be spent (transferred).

A critical point is that anyone with the appropriate secret key(s) can execute the transfer of the asset. Keys are often kept on a computer or mobile device, but they can also be stored on detached storage devices (such as a USB drive), a sheet of paper in a safe (referred to as "cold storage"), or even memorized (although relying on so-called "brain wallets" may not be advisable). In the most simplistic terms, using cryptocurrency in asset protection may simply involve the transfer of a private key to an offshore trustee (or manager).

Properly selected offshore trustees are unlikely to become subject to the jurisdiction of a court where a defendant may be sued. Absent jurisdictional authority, a court is powerless to compel the trustee to turn over assets. An added benefit is that blockchains are decentralized. This means they are not subject to any central authority (such as a bank or other financial institution) that might be legally compelled to provide a court with access or control over assets in its possession. Without the complete private key, no court or legal authority can manipulate ownership of a blockchain asset. Worries about a rogue trustee or manager can be allayed by requiring multiple keys, such that two (or more) parties are required for access. Those parties could be co-trustees, a trustee and trust protector, co-managers, or a manager and member of a board of directors. A trustee acting alone would have no ability to unilaterally access that portion of trust assets requiring multiple keys.

Cryptocurrency assets could also be divided, such that a small portion of currency remains under a single trustee's control whereas a larger portion is restricted and remains in cold storage subject to joint-key access. Because cryptocurrency transactions are semi-transparent and are time-stamped on the blockchain, ready proof is available to legitimize the timing and propriety of protective transfers. Transfers made well before assertion of a claim are far less likely to be challenged by creditors and courts. Such proof and transparency may be particularly useful when facing the threat of a contempt order, as mentioned above.

The Future Of Digital Currency

Additionally, unique potential exists for digital currencies as programmable money. It is not beyond the realm of possibility that digital currencies may one day be programmed to respond to pre-defined duress situations and to execute certain functions in the form of so-called "smart contracts." For instance, assets under control of a trustee who reports being summoned to appear in a hostile court might be programmed to immediately transfer to a successor trustee. Similarly, a trustee who fails to account to beneficiaries at pre-designated times might be effectively removed in a similar fashion by self-executing currency. As the technology develops and becomes more refined, smart contracts and the concept of programmable money will inevitably be integrated into asset protection planning.

The possibilities are utterly astonishing and as these financial technologies further evolve, so will additional use cases. This is just the very tip of the asset protection iceberg. Even now, cryptocurrencies, with their unique digital properties, transparency and decentralization, offer exciting, leading-edge opportunities as effective and legitimate modern asset protection tools.

"Alexa, Do You Have Rights?"

Legal Issues Posed by Voice-Controlled Devices and the Data They Create

By: Eric Boughman, Sara Beth A.R. Kohut, David Sella-Villa & Michael V. Silvestro

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The decision to use voice-controlled digital assistants, like Amazon's Alexa, Apple's Siri, Microsoft's Cortana, and the Google Assistant, may present a Faustian bargain. While these technologies offer great potential for improving quality of life, they also expose users to privacy risks by perpetually listening for voice data and transmitting it to third parties.

Adding a voice-controlled digital assistant to any space presents a series of intriguing questions that touch upon fundamental privacy, liability, and constitutional issues. For example, should one expect privacy in the communications he engages in around a voice-controlled digital assistant? The answer to this question lies at the heart of how Fourth Amendment protections might extend to users of these devices and the data collected about those users.

Audio-recording capabilities also create the potential to amass vast amounts of data about specific users. The influx of this data can fundamentally change both the strength and the nature of the predictive models that companies use to inform their interactions with consumers. Do users have rights in the data they generate or in the individual profile created by predictive models based on that user's data?

On another front, could a voice-controlled device enjoy its own legal protections? A recent case questioned whether Amazon may have First Amendment rights through Alexa. Whether a digital assistant's speech is protected may be a novel concept, but as voice-controlled digital assistants become more "intelligent," the constitutional implications become more far-reaching.

Further, digital assistants are only one type of voice-controlled device available today. As voice-controlled devices become more ubiquitous, another question is whether purveyors of voice-controlled devices should bear a heightened responsibility towards device users. Several security incidents related to these devices have caused legislators and regulators to consider this issue, but there remains no consensus regulatory approach. How will emerging Internet-of-Things frameworks ultimately apply to voice-controlled devices?

Voice-Activated Digital Assistants and the Fourth Amendment

Voice-activated digital assistants can create a record of one's personal doings, habits, whereabouts, and interactions. Indeed, features incorporating this data are a selling point for many such programs. Plus, this technology can be available to a user virtually anywhere, either via a stand-alone device or through apps on a smartphone, tablet, or computer. Because a digital assistant may be in perpetual or "always-on" listening mode (absent exercise of the "mute" or "hard off" feature), it can capture voice or other data that the user of the device may not intend to disclose to the provider of the device's services. To that end, users of the technology may give little thought to the fact their communications with digital assistants can create a record that law enforcement (or others) potentially may access by means of a warrant, subpoena, or court order.

A recent murder investigation in Arkansas highlights Fourth Amendment concerns raised by use of voice-controlled digital assistants. While investigating a death at a private residence, law enforcement seized an Amazon Echo device and subsequently issued a search warrant to Amazon seeking data associated with the device, including audio recordings, transcribed records, and other text records related to communications during the 48-hour period around the time of death. See State of Arkansas v. Bates, Case No. CR-2016-370-2 (Circuit Court of Benton County, Ark. 2016).

Should one expect privacy in the communications he engages in around a voice-activated digital assistant? The Arkansas homeowner's lawyer seemed to think so: "'You have an expectation of privacy in your home, and I have a big problem that law enforcement can use the technology that advances our quality of life against us.'" Tom Dotan and Reed Albergolti, "Amazon Echo and the Hot Tub Murder." The Information (Dec. 27, 2016), https://www.theinformation.com/amazon-echo-and-the-hot-tub-murder (hereinafter "Dotan").

To challenge a search under the Fourth Amendment, one must have an expectation of privacy that society recognizes as reasonable. With few exceptions, one has an expectation of privacy in one's own home, Guest v. Leis, 255 F.3d 325, 333 (6th Cir. 2001), but broadly, there is no reasonable expectation of privacy in information disclosed to a third party. Id. at 335-36. Any argument that a digital-assistant user has a reasonable expectation of privacy in information disclosed through the device may be undercut by the service provider's privacy policy. Typical privacy policies provide that the user's personal information may be disclosed to third parties who assist the service provider in providing services requested by the user, and to third parties as required to comply with subpoenas, warrants or court orders.

The Bates case suggests that data collected by digital assistants would bear no special treatment under the Fourth Amendment. The police seized the Echo device from the murder scene and searched its contents. Unlike a smartphone that would require a warrant to search its contents, see Riley v. California, 134 S. Ct. 2473, 2491 (2014), the Echo likely had little information saved to the device itself. Instead, as an internet-connected device, it would have transmitted information to the cloud, where it would be processed and stored. Thus, the Arkansas law enforcement obtained a search warrant to access that information from Amazon.

Under existing law, it is likely a court would hold that users of voice-activated technology should expect no greater degree of privacy than search engine users. One who utilizes a search engine and knowingly sends his search inquiries or commands across the Internet to the search company's servers should expect that the information will be processed, and disclosed as necessary, to provide the requested services.

Perhaps there is a discernible difference in that voice data, to the extent a service provider records and stores it as such, may contain elements that would not be included in a text transmission. For example, voice data could reveal features of the speaker's identity (such as a regional accent), state of mind (such as excitement or sadness), or unique physical characteristics (such as hoarseness after yelling or during an illness), that would not be present in text.

Or perhaps it is significant that some information transmitted might enjoy a reasonable expectation of privacy but for the presence of the device. Although digital-assistants usually have visible or audio indicators when "listening," it is not inconceivable that a digital assistant could be compromised and remotely controlled in a manner contrary to those indicators.

Further, the device could be accidentally engaged, particularly when the "wake word" includes or sounds like another common name or word. This could trigger clandestine or unintentional recording of background noises or conversations when the device has not been otherwise intentionally engaged. See Dotan ("[T]he [Echo's seven] microphones can often be triggered inadvertently. And those errant recordings, like ambient sounds or partial conversations, are sent to Amazon's servers just like any other. A look through the user history in an Alexa app often reveals a trove of conversation snippets that the device picked up and is stored remotely; people have to delete those audio clips manually.").

The technology of voice-activated digital assistants continues to advance, as evidenced by the recent introduction of voice-controlled products that include video capabilities and can sync with other "smart" technology. Increasing use of digital assistants beyond personal use will raise more privacy questions. As these devices enter the workplace, what protections should businesses adopt to protect confidential information potentially exposed by the technology? What implications does the technology have for the future of discovery in civil lawsuits? If employers utilize digital assistants, what policies should they adopt to address employee privacy concerns? And what are the implications under other laws governing electronic communications and surveillance?

First Amendment Rights For Digital Personal Assistants?

The Arkansas v. Bates case also implicates First Amendment issues. Amazon filed a motion to quash the search warrant, arguing that the First Amendment affords protections for both users' requests and Alexa's responses to the extent such communications involve requests for "expressive content." The concept is not new or unique. For example, during the impeachment investigation of former President Bill Clinton, independent counsel, Kenneth Starr, sought records of Monica Lewinsky's book purchases from a local bookstore. See In re Grand Jury Subpoena to Kramerbooks & Afterwords Inc., 26 Media L. Rep. at 1599 (D. D.C. 1998). Following a motion to quash filed by the bookstore, the Court agreed the First Amendment was implicated by the nature of expressive materials, including book titles, sought by the warrant. Ms. Lewinsky's First Amendment rights were affected, as were those of the book seller, whom the court acknowledged was engaged in "constitutionally protected expressive activities." Id. at 1600. Content that may indicate an expression of views protected by free speech doctrine may be protected from discovery due to the nature of the content. Government investigation of one's consumption and reading habits is likely to have a chilling effect on First Amendment rights. See U.S. v. Rumely, 345 U.S. 41, 57-58 (1953) (Douglas, J., concurring); see also Video Privacy Protection Act of 1988, 18 U.S.C. § 2710 (2002) (protecting consumer records concerning videos and similar audio-visual material).

Amazon relied on the Lewinsky case, among others, contending that discovery of expressive content implicating free speech laws must be subject to a heightened standard of court scrutiny. This heightened standard requires a discovering party (such as law enforcement) to show that the State has a "compelling need" for the information sought (including that it is not available from other sources) and a "sufficient nexus" between the information sought and the subject of the investigation.

The first objection raised by Amazon did not involve Alexa's "right to free speech," but instead concerned the nature of the "expressive content" sought by the Echo user and Amazon's search results in response to the user's requests. The murder investigation in question, coupled with the limited scope of the request to a 48-hour window, may present a compelling need and sufficient nexus that withstands judicial scrutiny.

However, Amazon raised a second argument that Alexa's responses constitute an extension of Amazon's own speech protected under the First Amendment. Again, the argument is supported by legal precedent. In Search King, Inc. v. Google Tech., Inc., an Oklahoma federal court held that Google's search results were constitutionally protected opinion. 2003 WL 21464568 (W.D. Okla. 2003). More recently, a New York federal court determined that Baidu's alleged decision to block search results containing articles and other expressive material supportive of democracy in China was protected by the First Amendment.

Jian Zhang v. Baidu.com, Inc., 10 F.Supp.3d 433 (S.D.N.Y. 2014). Accordingly, no action could lie for injunctive or other relief arising from Baidu's constitutionally protected decisions.

The court considered search results an extension of Baidu's editorial control, similar to that of a newspaper editor, and found that Baidu had a constitutionally protected right to display, or to consciously not display, content. The court also analogized to a guidebook writer's judgment about which attractions to feature or a political website aggregator's decision about which stories to link to and how prominently to feature them. Id. at 438.

One unique issue that arises in the context of increasingly "intelligent" computer searches is the extent to which results are not specifically chosen by humans, but instead returned according to computer algorithms. In Baidu, the court was persuaded by the fact that the algorithms are written by humans and thus "inherently incorporate the search engine company engineers' judgments about what materials" to return for the best results. Id. at 438-39. By its nature, such content-based editorializing is subject to full First Amendment protection because a speaker is entitled to autonomy to choose the content of his message. In other words, to the extent a search engine might be considered a "mere conduit" of speech, First Amendment protection might be less (potentially subject to intermediate scrutiny), but when the search results are selected or excluded because of the content, the search engine, as the speaker, enjoys the greatest protection.

Search results arising from computer algorithms that power search engines and digital assistants may currently be considered an extension of the respective companies' own speech (through the engineers they employ). Current digital assistants are examples of "weak artificial intelligence." Thornier legal questions will arise as the artificial intelligence in digital assistants gets smarter. The highest extreme of so-called "strong" artificial intelligence might operate autonomously and be capable of learning (and responding) without direct human input. The First Amendment rights of such systems will no doubt be debated as the technology matures.

Voice Data and Predictive Models

Digital assistants have the potential to gather massive amounts of data about users. Current voice data analytic tools can capture not only the text of human speech, but also the digital fingerprint of a speaker's tone, intensity, and intent. Many predictive models rely extensively on lagging indicators of consumption, such as purchases made. Voice data might be able to provide companies with leading indicators, such as information about the user's state of mind and triggering events that may result in the desired interactions with a company.

Incorporating voice data into current predictive models has the potential to make them vastly more accurate and specific. A digital assistant might record and transmit the message "Pat is going to the hospital for the last time." Based on only text of the message, an algorithm might predict that a tragic event is about to take place. But with a recording, analysis of the voice's pitch, intensity, amplitude, and tone could produce data that indicates that the speaker is very happy. Adding such data into the predictive model, might result in the user beginning to see ads for romantic tropical vacations, instead of books about coping with grief.

User interactions with digital assistants will also give rise to new predictive models. Before going to sleep, a user might ask a digital assistant to play relaxing music, lower the temperature of the home, and turn off certain lights. With a new predictive model, when the user asks the digital assistant to play relaxing music at night, the digital assistant might recognize the user's "going to sleep sequence," and proceed to lower the temperature of the home and turn off lights automatically.

In addition to the richness of data in a single voice recording, predictive models based on voice interactions with digital assistants are potentially more robust because digital assistants are always "listening." This "listening" largely takes the form of recording the voice interactions between the user and the digital assistant. Terms of service of the most popular digital assistants typically do not indicate the precise moment when recording starts. Some voice-controlled products have been marketed with an increased focus on privacy concerns. Apple's forthcoming HomePod speaker, for instance, is said to be designed so that no voice data is transmitted from the device until the "wake word" is spoken.

A digital assistant may begin recording and analyzing voice data even when it is not specifically "turned on" by the user. This makes the potential data set about the user much larger, which results in a more robust predictive model. If the digital assistant is always "listening," its owners' statement, "I'm going to take a nap," could trigger the "going to sleep sequence" described above. If voice recordings are used in conjunction with current predictive models, a user's statement, "we're expecting a child," could be used as a very powerful leading indicator of specific future purchases.

Legal analysis in this growing field should distinguish voice-data recordings (and data derived from these recordings) from the text of these recordings. The current legal framework applicable to voice recordings captured by digital assistants and their use in predictive models is very limited. California has enacted a statute governing certain uses of voice recordings collected from connected televisions. See CA Bus. & Prof. Code §22948.20. However, the states generally have not regulated the use of voice recordings from digital assistants, and have permitted use of voice data in various predictive models with relatively little restriction.

Each digital assistant has terms of service and privacy policies that their parent companies promulgate (and change from time to time). Users, therefore, should know that voice recordings are captured by digital assistants with their consent. The terms of service for some digital assistants specifically note that voice recordings may be used to improve the digital assistant itself and may be shared with third parties. Thus, voice data is likely to be used in predictive models.

Call centers have been using real-time voice-data analytics systems. Interestingly, as part of these technology packages, certain voice-data analytics systems can detect and scrub personally identifiable information from voice recordings. Digital assistants may use similar technologies to avoid recording and storing regulated content (e.g., health information, financial information, etc.) to avoid becoming subject to privacy regulations. Doing so may expose those recordings for use in various predictive models.

Even if digital assistants only record interactions between the user and the device, the richness of voice data means that predictive models may become finely tuned to each individual user. Every interaction with a digital assistant may help build a unique user profile based on predictive modeling.

As discussed in this article, certain elements of a user's interaction with the digital assistant may include "expressive content," and both the user and the digital assistant may have constitutional protections. If a digital assistant develops a rich user profile based on both "expressive content," and data from other sources, how much of that profile still enjoys constitutional protections? As individuals sacrifice privacy for convenience offered by digital assistants, will their profile will become more akin to a private journal? As the technologies develop, what rights can the individual be said to have given up to the discretionary use of the service provider and third parties?

Voice Data and the Internet of Things

Digital assistants are not the only voice-controlled devices available to consumers. What about voice-controlled devices that may seem innocuous, or might not even be used by the actual purchaser, like an internet-connected children's toy? Unsurprisingly, there have already been a few well-publicized data security incidents involving voice data from these types of products. Although the products may be relatively niche at present, the issues raised are not and underscore broader risks associated with the use and collection of consumer-voice data.

One security incident involved a line of internet-connected stuffed-animal toys. The toys had the ability to record and send voice messages between parents (or other adults) and children through a phone-based app. Voice data from both parents and children was collected and stored on a hosted service. Unfortunately for users, the voice-recording database was publicly accessible and not password protected. Over two million voice recordings were exposed. Worse still, third parties gained unauthorized access to the voice data and leveraged it for ransom demands. Over 800,000 user account records were compromised.

Another recent incident involved a doll offering interactive "conversations" with users. Voice data was transferred to a third-party data processor, who reserved the right to share data with additional third parties. When this toy was paired with an accompanying smartphone app, voice data could be accessed even without physical access to the toy. Security researchers discovered paths to use an unsecured Bluetooth device embedded in the toy to listen to – and speak with – the user through the doll.

Concerns over this doll and other similar products have triggered responses from European governmental agencies. For example, in December 2016, the Norwegian Consumer Council published a white paper analyzing the end-user terms and technical security features of several voice-controlled toys. Forbrukerrådet, #Toyfail: An analysis of consumer and privacy issues in three internet-connected toys (Dec. 2016) https://fil.forbrukerradet.no/wp-content/uploads/2016/12/toyfail-report-desember2016.pdf. Complaints have also been filed with privacy watchdog agencies in several European Union member states, including France, the Netherlands, Belgium, and Ireland. Some complain that voice data is collected and processed by third parties in non-EU states, like the United States, who are not subject to EU privacy and use regulations. Third parties include voice-data processors who also perform voice-matching services for law-enforcement agencies.

More recently, German regulators announced that the sale or ownership of one such toy was illegal under German privacy laws after the toy was classified as a "hidden espionage device." Although German regulators are not pursuing penalties against owners, they have instructed parents to physically destroy the toy's recording capabilities. This unusual step may ultimately signal increased regulation of voice controlled consumer products under German law.

Complaints regarding similar products have also been filed in the United States with the Federal Trade Commission and other bodies. Privacy groups have questioned whether these devices comply with the consent requirements of the Children's Online Privacy Protection Act (COPPA) and its associated rules and regulations. COPPA applies to operators of online sites and services involved in collecting personal information from children under 13 years of age and provides additional protections that may be applicable to voice-controlled toys. Aside from COPPA, given the lack of comprehensive legislation or regulation at the federal level, there remains a patchwork of state and federal laws that may regulate voice-controlled products. One bill that covers voice data (as part of a broad class of personal information) has passed the Illinois State Senate and is now pending in the Illinois State House. The Right to Know Act, HB 2774, would require operators of websites and online services that collect personally identifiable information to: (i) notify customers of certain information regarding the operators' sharing of personal information, including the types of personal information that may be shared and all categories of third-parties to whom such information may be disclosed; (ii) upon disclosure to a third-party, notify consumers of the categories of personal information that has been shared and the names of all third parties that received the information; and (iii) provide an email or toll-free phone number for consumers to access that information. Importantly, the current draft of the Illinois Right to Know Act also creates a private right of action against operators who violate the Act. Whether this bill or similar laws will be enacted remains an open question.

Conclusion

Data collected by voice-controlled digital assistants and other connected devices presents a variety of unresolved legal issues. As voice-controlled features continue to develop, so too will litigation, regulation, and legislation that attempt to balance the rights of users, service providers, and perhaps even the underlying technology itself. The issues presented in this article are deeply interrelated. When even one of the associated legal questions is settled, other issues in this emerging field could quickly follow suit, but new issues will likely emerge.

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Privacy Considerations Raised by Artificially Intelligent Digital Assistants

By: Eric Boughman

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It has been said that the term "eavesdropper" evolved from those who stood under the eaves of a house to surreptitiously listen to the goings-on inside. In this age of digital advancement, we now invite eavesdroppers into our homes and offices in the form of artificially intelligent digital assistants. While devices like the Google Home, Apple's Siri, and the Amazon Echo offer great convenience and enjoyment, there are privacy trade-offs; and some are less obvious than others.

When you welcome one of these devices into your home or workspace, you add a digital device that is at your beck and call because it is always "listening." For instance, Google Home listens to snippets of conversations to detect the "hotword" and Amazon's Echo begins streaming to the cloud "a fraction of a second of audio before the wake word" (typically, the word is "Alexa") is detected. When we use the "hotword" or "wake word" to summon these devices, it should come as no surprise that our interactions are tracked and recorded by the device's service provider.

You can review and delete your history but that comes with tradeoffs as well. Google explains that deleting your interaction history will limit the personalized features of your Google Assistant. (Look here to view your interaction history with Google.) Amazon similarly explains that deleting your voice recordings "may degrade your Alexa experience." Apple is more elusive. It has stated that it will anonymize and encrypt voice data from its forthcoming HomePod speaker, but less clear is what Apple actually intends to do with that encrypted data. Data generated from user interactions with artificially intelligent digital assistants is typically captured and sent to the service provider's cloud for storage and processing. This data, which we voluntarily provide, can then be analyzed and used by the service provider in machine learning to develop and strengthen artificial intelligence systems.

Data is vital for this. Machines need data to learn – the more the better – and digital assistants have the power to capture vast amounts of it. Few consider, however, what happens to the data we provide or, for that matter, even the type of data we provide.

Digital Assistants obviously capture voice data from the user which can be converted to text. But less obvious is the information captured about the user. Information about you is much richer than mere text. Do you engage your digital assistant at the same time every morning? Do you speak with an accent? What type of mood were in when you asked for that Van Morrison song? Do you regularly turn down your "smart" thermostat and dim your lights at the same time each evening, except on Saturdays? What type of ambient background noise is typically present? How many people live in your home? Are any children?

In addition to text-based information, digital assistants might capture your voice tone, inflection, volume, and behavioral patterns. Data about user interactions has the potential to be incredibly valuable. Big data has become a catch-phrase for the industry of companies collecting, analyzing, and processing vast quantities of data. Some companies, like Soul Machines and Air New Zealand, are already working on creating machines that can detect human emotion and communicate empathically. While this may improve customer service experiences, it may also be used to influence shopping and travel habits, persuade viewing and entertainment preferences, and perhaps even predict – or manipulate - elections.

Here in the U.S., we enjoy a right to be free from government intrusion into our private lives, but that right exists only when we have a reasonable expectation of privacy. What privacy expectations are reasonable when we share so much about ourselves with a digital assistant? European law is wrestling with some of these issues, but outside of the healthcare and financial arenas, and companies targeting children, U.S. legal doctrine is not currently well-equipped to deal with the treatment of big data and the companies who collect and use it. [1] For now, courts will need to deal issues on a case-by-case basis.

To determine your rights in the information you provide to your digital assistant, you'll need to consult with the service provider's terms of service and privacy policy. You may find, however, that your privacy expectations are not supported by a service provider's actual terms. Both Google and Amazon disclose that the content of your requests may be shared with third parties. Other companies likely have similar policies. To what extent, if any, can users reasonably hold any expectation of privacy from government monitoring or private sharing?

Beyond the content of your requests, what about other information about you? Companies tend to be less clear about what happens with the non-text based data they capture, store, and share about their users. Besides your written interactions, what other information does your service provider share? Usage habits? calendar details? Shopping lists? These are some of the questions to ponder when using your digital assistant.

"To determine your rights in the information you provide to your digital assistant, you'll need to consult with the service provider's terms of service and privacy policy."

1. See generally, Health Insurance Portability and Accountability Act of 1996 (HIPAA) Privacy Rule, 45 CFR Part 160 and Subparts A and E of Part 164, as to medical records; the Gramm-Leach-Bliley Act (GLBA), 15 U.S.C. §§ 6801-27, as to financial institutions; and the Children's Online Privacy Protection Act (COPPA), 15 U.S.C. §§ 6501-06, which pertains to Children under 13.

We live in the information age- in the age of big data. This data can be used to enrich our lives but it also has the potential to provide vastly more information about users than what users expressly intend. By now, many are aware of Amazon's fight with law enforcement over the disclosure of Echo transcripts. How many also know that police relied on data from a smart water meter showing abnormally high water usage as evidence in its investigation? As companies continue to collect data about users – and as predictive models for this data are fine-tuned, courts will need to redefine the parameters of reasonableness when it comes to the expectation of privacy.

For now, users of these devices need to be aware of the privacy paradox offered by artificially intelligent digital assistants. As the saying goes, if you don't know what the product is, then you are the product. The question is ripe with respect to digital assistants: Are we the customer, or are we the product? Or, is it a combination of both?

"Digital Assistants obviously capture voice data from the user which can be converted to text. But less obvious is the information captured about the user."

Is there an Echo in here?

By: Eric Boughman

Published in *Forbes*

If you have an Amazon Echo, here is something to try: Say, "Alexa, tell me a joke," but do it very quickly so that you finish the request before Alexa "wakes up" (indicated on the Echo by the blue light). Did you notice that Alexa dutifully complied, seeming to have caught the request even before she (it?) was awake? There is a simple explanation for this: Alexa (like other artificially intelligent digital assistants) is always "listening." Indeed, Alexa starts recording "a fraction of a second" before the wake word. Google Home listens to snippets of conversations to detect the "hotword."

After becoming more familiar with Alexa at home, I considered adding an Echo or similar device to my law office. I imagined the added convenience of having my own artificially intelligent digital assistant in the office. She could make notes and calendar entries, add items to my checklist, tell me whom I'm meeting for lunch and where, and perhaps add time entries and quickly retrieve obscure facts, all with a simple verbal command. But since smart devices like Alexa are always listening, the added convenience comes with a tradeoff - one with substantial privacy implications. How comfortable would you be knowing that transcripts of your verbal interactions are kept by many digital assistants' service providers?

What are your rights to restrict the use and dissemination of collected voice data? Can private parties or the federal government obtain this data through a subpoena, search warrant, or court order (or without)? To challenge a search under Fourth Amendment, you must have a reasonable expectation of privacy. Is such expectation reasonable in the presence of a digital assistant? While these devices are generally designed only to record information once a designated "wake" word is spoken, few consider the practical reality that to detect the wake word, the device must always be "listening" for it.

What if a device is accidentally activated? In a recent client meeting, someone answered in agreement to a question, beginning with, “sure, he can do that…” On a nearby I-phone, Siri "heard" her name and began actively listening. Even scarier: a friend recently explained how he loves his new Samsung Galaxy phone but is annoyed that "Bixby" (Samsung’s AI assistant) is often triggered unintentionally and seems to have a mind of his own. Accidental activations, often through similar sounding words or simple software glitches, create risks of unintended recordings.

Additional risks are present in the data you intend to share. Your privacy expectations may be undercut by a service provider's terms of service or privacy policy for a given device. For instance, as disclosed by Alexa’s Terms of Use, if you access third party services and apps through Alexa, Amazon (naturally)

shares the content of your requests with those third parties. Amazon further discloses that data you provide may be stored on foreign servers. As such, U.S. Fourth Amendment protections may not apply.

Amazon handles the information received from Alexa in accordance with its privacy policy. Your interactions with Alexa, including voice recordings, are stored in the cloud. You can review and delete them, but Amazon explains that deleting them may degrade your Alexa experience. Google similarly explains that deleting your interaction history will limit the personalized features of your Google Assistant. Artificially intelligent devices need data from users – the more the better - to "learn" and adapt. The privacy paradox is that users must therefore agree to sacrifice some degree of privacy to enrich the user experience.

Companies like Amazon and Apple have made headlines vigorously defending their customers' privacy. But what about third parties with whom they subcontract for services? Apple is notoriously stingy about sharing information, but both Google and Amazon acknowledge sharing information with third party providers, generally to "improve the customer experience." Will these third parties – some perhaps overseas – defend privacy as vigorously if challenged? Under the third-party doctrine, Fourth Amendment privacy protections are lost when otherwise private information is freely shared.

In its current form, application of the third-party doctrine suggests that any communication you may have with your personal digital assistant may be subject to search and compelled disclosure because it is freely shared with the service provider. This would clearly seem to be the case with verbal interactions occurring after wake word activation, but what about recordings that may have been unintentional or, worse, surreptitious?

For attorneys, there are additional questions that arise as to how the presence of an artificially intelligent, always-listening assistant may impact attorney-client privilege. The privilege, which protects as confidential the communication between an attorney and client, is generally held as sacrosanct by courts, but it can be lost when the substance of those communications is shared with a third-party. Moreover, courts routinely find that information in the hands of third parties is not protected by the attorney-client privilege. Does the presence of a digital assistant put that privilege at risk?

To what degree might a court carve an exception to privacy or privilege protections for information recorded through digital assistants? The technology landscape is moving fast and current legal doctrine is often ill-equipped to deal with new issues. For now, if I decide to add a "smart" digital assistant to my office, I'll be sure to unplug or deactivate it during any meetings that I wish to remain confidential.

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