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OFFSHORE PILOT QUARTERLY

Commentary on Matters Offshore

December, 2003. ***Volume 6 Number 4***

Bedlam and Bureaucrats

The Offshore Pilot Quarterly celebrates its sixth anniversary with this issue at a time when some of Britain's dependent territories are feeling the heat from Whitehall. Raised voices in dependencies such as the British Virgin Islands and the Cayman Islands have been heard concerning Britain's intention to have these dependencies comply with EU directives. Much of the rhetoric carries the implication that acquiescence would be a voluntary act which illustrates a dictum of John Maynard Keynes who once observed that "starting with a mistake, a remorseless logician can end up in Bedlam". Readers are reminded of the previous comments made by the British Chancellor, Gordon Brown, at an informal meeting of European Union finance ministers in Stresa, Italy, when he said that the Cayman Islands might find legislation forced on it if it refuses to comply with the terms of the European Savings Tax Directive (a subject covered in several previous issues of the Offshore Pilot Quarterly) which comes into force in January, 2005. The Cayman Islands government tried, unsuccessfully, to get the European Court of Justice to form a working party to consider the tax directive. The end result is a grand illustration of bureaucratic obfuscation and which supports the contention of Bismarck who felt that the making of laws had much in common with sausages: it was better not to see them being made. Seemingly to throw a straw at a drowning man, the European Court of Justice of First Instance ruled that although a Commission Working Party would not be countenanced, the EU had no power to impose an obligation on the Cayman Islands to comply with its Directive on the Taxation of Savings Income. At this point, some Caymanians might have been in a celebratory mood, even more so when the court went on to say that nor was the United Kingdom legally obliged as a full member of the EU to force the directive on the islanders. Popping champagne corks with parties on Grand Cayman's Seven Mile Beach might have become a reality if, having given false hope, the court had not then delivered its coupe de grace by stating that whether or not, however, the United Kingdom could constitutionally impose the directive by an Order in Council was an issue beyond the jurisdiction of the court.

Being familiar with the process behind both the drafting and promulgation of legislation in a British dependent territory, it is clear to me that whilst the future direction of offshore financial services in British dependencies might be uncertain, the power that the British government has to influence the direction is not. The first issue of this newsletter in 1997 commented that there was something very reassuring about an offshore financial services centre located in a sovereign state. Events since then have only reinforced that opinion.

The Good Ship OECD

Offshore financial services provided by sovereign states can be a thorn in the side of not only the EU but the Organisation for Economic Co-operation and Development also. The OECD has grown from

18 to 30 members since it was established in 1961, a successor to the Organisation for European Economic Co-operation which had administered the aid given by the United States of America and Canada under the Marshall Plan to Europe at the end of the second world war. The OECD's geographical spread, the conflicting interests of its members, its budgetary constraints and its decision-making process make it a bureaucratic behemoth. The OECD endorses economic and social policies which often translate into accepted policies in both member and non-member countries and has been described as a think-tank, a rich man's club and an unacademic university (which, in the latter case, perhaps only confers a degree of scepticism.) Now, however, it has a new appellation: a big ship, and one that is adrift in search of a harbour. Certainly, much of the OECD's policies give the impression that it is all at sea. Remarkably, the comparison was made by none other than Donald Johnston, the Canadian general-secretary of the Paris-based OECD, who went on to say "it is time to concentrate on our destination". It is true that the OECD appears to be mimicking Hamlet, the tragedy of a man who could not make up his mind, and that its resolutions sometimes remind one of hot dogs following the general comments made about resolutions by an American diplomat who said that, like hot dogs, "If you know how they make 'em, you don't want to eat 'em. You just swallow. No questions asked". Much like Bismarck's sausages.

Not surprisingly, this drifting ship is passing through heavy seas, as illustrated by the October meeting of the organisation in Ottawa, Canada, which was also attended by representatives from offshore financial services centres. It was a forgone conclusion that the closing joint statement in Ottawa released by the co-chairs, Gabriel Makhlouf from the OECD and Dr. Terepai Maote, deputy Prime Minister and Finance Minister of the Cook Islands, would contain language which acknowledged that the desired level playing field (concerning the OECD tax initiative) had not yet been achieved because "the level playing field is fundamentally about fairness". It is worth reminding readers that in the June, 2002, issue of this newsletter ("Makhlouf's Nightmare) this observation was made in connection with the OECD tax initiative: "When one steps back and considers the international ramifications and imponderables surrounding the OECD initiative, it would be a brave commentator who confidently predicted that the OECD will achieve its goal by the end of 2005".

Size matters also. Prior to the meeting, Glenroy Forbes of the International Trade and Investment Organisation commented that "The OECD has praised our co-operation but is sadly unable to deliver its own key members". The Panamanian delegation attending the Ottawa meeting vigorously objected to the existing state of play which ran counter to the understanding that there would be no compromises in reaching an accord whereas, clearly, some of the OECD members are unwilling to subject themselves to laws expected to be observed by smaller jurisdictions, such as Panama.

Anacharis, the ancient philosopher, likened laws to cobwebs in that they were strong enough to restrain the weak but too weak to restrain the strong. So it is doubtful if the good ship OECD is going to encounter an easy passage through the Panama canal in search of that safe harbour. At the Battle of Jutland in 1916 Earl David Beatty said that "There's something wrong with our bloody ships today, Chatfield". That certainly remains so, at least in one case.

A Joy Named Sue

Country music fans of a certain age will recognise that this segment's caption is a variation of the title of a Johnny Cash song. It sums up the present state of litigation in the United States of America which is all about cash, but with a small "c". Tort, a private or civil wrong or injury for which the court provides a remedy, has become sheer torture and the Council of Economic Advisers in 2002 reckoned that America's tort system absorbed 1.8 per cent of GDP ($180 billion a year.) It has been said that America has a liability crisis on its hands with over 15 million cases being processed annually, just in state courts. The good intentions behind tort remind one of Prometheus, of Greek

mythology, who stole fire from heaven and gave it to mankind also with the desire to do good, but who was punished by the gods for giving mankind power and with it the power of choice. Today, more and more Americans are choosing to sue.
The consequences of today's litigation epidemic in America has, like internet spam, hampered the smooth flow of commerce; it has made businessmen fearful in some cases and overly cautious in others. There seems to have been a general acceptance, endorsed by court decisions, that the likelihood of someone being completely responsible for their actions is only just slightly more feasible than Martians landing on earth. That said, two examples shine as rays of reason and prove that common sense can still prevail. The late 1990s stock market débâcle, with its attendant internet bubble, has generated lawsuits for billions of dollars against securities companies, including Merrill Lynch. The firm has been pilloried by public prosecutors (a lynching in more ways than one) who have accused it of being part of a stock market manipulation undertaken by Wall Street's investment bankers and research analysts. Federal Court Judge Milton Pollack, however, who heard 2 suits against Merrill Lynch, thinks differently and rejected them. It is worth quoting from the judge's conclusions which, besides displaying a colourful turn of phrase, encapsulate the heart of the matter.

"The record clearly reveals that plaintiffs were among the high risk speculators who, knowing full well or being properly chargeable with appreciation of the unjustifiable risks they were undertaking in the extremely volatile and highly untested stocks at issue, now hope to twist the federal securities laws into a scheme of cost-free speculators' insurance. Seeking to lay the blame for the enormous Internet Bubble solely at the feet of a single actor, Merrill Lynch, plaintiffs would have this Court conclude that the federal securities laws were meant to underwrite, subsidize, and encourage their rash speculation in joining a freewheeling casino that lured thousands obsessed with the fantasy of Olympian riches, but which delivered such riches to only a scant handful of lucky winners. Those few lucky winners, who are not before the Court, now hold the monies that the unlucky plaintiffs have lost – fair and square – and they will never return those monies to plaintiffs. Had plaintiffs themselves won the game instead of losing, they would have owed not a single penny of their winnings to those they left to hold the bag (or to defendants)."

What has brought us to this juncture? 75 years ago things were decidedly different in America and individual responsibility counted. In 1928, Helen Palsgraf was waiting for a train to Rockaway Beach when a man dropped a packet of fireworks on the railway track. A passing train caused the packet to explode which then caused a weighing machine to fall on Mrs. Palsgraf who then sued the railroad. An appeals court decided, however, that the responsibility for Mrs Palsgraf's injuries did not "reach" the railroad and as a consequence of the ruling, Palsgraf v Long Island Railroad became a precedent. McDonald's, the pervasive purveyor of hamburgers, illustrates how things have changed since then. Besides the scales of justice, weighing machines, by an odd coincidence, are again at the centre of the controversy; this time it is only because of what they reveal when you stand on one. The 2002 case of Pelman v McDonald's accused the fast-food company of being responsible, inter alia, for the size of a 270 lb. child in New York City because its French fries and hamburgers didn't come with warnings that they can materially (no pun intended) cause obesity. This in a country where a RAND study has determined that the number of severely obese people has quadrupled since 1986 with around 1 adult in 50 being at least 100 pounds overweight.
It should not be surprising that we have reached this point when, in 1994, McDonald's had already had to pay a reported $300,000 in a US court case to a complainant who was burnt by one of its hot drinks. Fortunately for McDonald's, Europe has not yet reached the level of litigation lunacy that America has. In a similar case in the United Kingdom (Bogle v McDonald Restaurants) Mr. Justice Field dismissed the suit, declaring that people who buy a cup of tea or coffee expect it to be hot so there is no

obligation on the part of the restaurant to warn customers of the obvious: hot drinks can scald if spilled. Judge Pollack would, I am sure, have enjoyed discussing the case with Justice Field, probably over a cup of coffee.

In 2000 the Offshore Pilot Quarterly commented on the Alien Tort Claims Act, an anachronistic piece of legislation which has its roots in America's first Judiciary Act of 1789. Legislation that was probably meant to address piracy is being used today to allow courts in America to even "reach" beyond the country's borders, let alone as far as the Long Island Railroad. Foreign banks and companies, rather than buccaneers, are being brought to court in America, even though they have already answered to the courts in their home jurisdiction, and those courts have ruled in their favour. New York's federal district court has cases pending against Credit Suisse, Deutsch Bank, Dresdner Bank, Fujitsu and Unisys. And American companies are not immune from the perversity of plaintiffs. It may have been thrown out of court, but in one instance a Delaware-registered firm was sued in New York for pollution in Peru, where it operated.

The infamy of the Internal Revenue Service is being overtaken by the terror of tort which has become a strong motive behind creating offshore structures. Besides a war on terror there is now a war on error. Mclawsuits abound and taxes can become a small price to pay for insulating assets (see "Taxation and Transparency: So what?" in the June, 2002, issue of the Offshore Pilot Quarterly.) Worryingly, many American judges, rather than interpreting the laws, appear to be sidetracking legislators and creating them from the bench.

Is it any wonder that offshore trusts and foundations are so popular? Another Johnny Cash song, "I Walk the Line", was also a huge hit. It is a song title which, for many professionals and businesses operating in America's litigious climate, speaks for itself. With more lawsuits onshore you can expect to see more business suits offshore.

Offshore Pilot Quarterly is published by Trust Services, S. A. which is a British- managed trust company licensed under the banking laws of Panama. It is written by our Managing Director who is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking and insurance regulator. He has over 35 years private and public sector experience in the financial services industry. Our website provides a broad range of related essays.

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