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Yorkshire Pudding and Empanadas

In December, 1997, the first issue of the Offshore Pilot Quarterly was published. In more ways than one that first issue was a pilot because it wasn't certain whether or not the newsletter would be worthwhile; ten years later we are left in no doubt. Originally, the OPQ was meant to be a source of information for our clients with the topics presented in a way that would hold (hopefully) the reader's interest; a great deal of reliance has been placed on humour and history in presenting some of the observations and analysis. The approach seems to have worked despite the bland nature of many of the elements which comprise the financial services industry.

It has been suggested that a work of fiction would be a worthwhile exercise and certainly my experiences of bankers turned buccaneers, companies controlled by conmen, mixed in with an array of trickster trustees, would provide sufficient inspiration; but it was Mark Twain who said that fiction is obliged to stick to possibilities whilst truth wasn't. How right he was and so for now I'll stick to reality and the dusty, unedited manuscript in my study will have to stay there for a while longer. Back to reality.

"If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely the development from century to century of the trust idea". Those words were spoken by the prominent 19th century British legal historian, Francis Maitland, whose words I quoted recently in Panama when I gave a talk to the local branch of the Society of Trust and Estate Practitioners on the subject of trusts, the field which I have spent practically my entire professional career in.

The trust has traversed the globe but in Latin America its concepts have not been as easily digested; think of Yorkshire pudding with empanadas. Bearer shares are known, flippantly, as the South American's answer to a trust. And certainly they remain popular in the region despite their oft-quoted sinister connotations. Delivering ownership upon demise as easily as you would the bearer bank note in your pocket is very attractive – provided the intended party and not a pick-pocket is the recipient. In the context of estate planning, the basic question raised by bearer shares is this: how secure is the chain of control between death and delivery?

The "trust idea" in Panama (the region's leading Spanish-speaking offshore centre) is an import because it never formed a part of a legal system brought from Spain by the conquistadores (a trust law first appeared in Colombia in 1923). Panama's first trust law was promulgated in 1925 and, I suspect, prompted more to facilitate commercial enterprises with North America than for any other reason.

Trusts are a distinct creation of English law and so blending this offspring of English equity (see next segment) with a civil law system, such as the one Panama has, presents difficulties. In offshore financial services, however, ready international acceptance of trusts is essential and I told the local STEP branch members that like the ships that

Panama welcomes to its shores from all over the world, it should embrace the differences between its own laws and those of other countries.

It is natural for lawyers, whether in Panama or elsewhere, to assert that their own legal system is, despite any imperfections, the finest available. They are often critical of other systems and I am reminded of the United States of America lawyer and political figure, Newton Minnow, who, during the days of the old Soviet Union, said: "In Germany, under the law everything is prohibited except that which is permitted. In France, under the law everything is permitted except that which is prohibited. In the Soviet Union, everything is prohibited, including that which is permitted. And in Italy, under the law everything is permitted, especially that which is prohibited".

Earlier in the year I wrote an article for STEP's magazine, The Journal, suggesting that although Panama does have trust legislation, should there be a surge of trust business in the future (because of the country's growing status as an offshore centre) the relative lack of practical experience and legal precedents available might present problems when complex trust disputes arise. (This will also be touched upon in my Latin Letter column next February in the Offshore Investment.com).

The same argument, but in relation to foundations, could apply to those common law offshore jurisdictions which have incorporated foundations into their legislation as part of a drive to be men for all seasons; unfortunately, English history, at least, has shown that such men can sometimes lose their heads. The Swiss, with a civil law system, have addressed the issue by having the laws of other jurisdictions (such as the Channel Islands) govern their trusts.

I understand the difficulties this English interloper might present in Panama because my own study of trust law (a pursuit, inevitably, which has never ended) began in the Roman Dutch law environment of South Africa and Rhodesia (which is now Zimbabwe). This legal system was introduced by way of the first European settlers in South Africa and then travelled north across the Limpopo river with the Pioneer Column (inspired by Cecil Rhodes) into the former Rhodesia. Subsequently, elements of English law – particularly the trust – were grafted on to the civil law due to the English conquest of both countries.

The result is an interesting one: a civil law system in which the English trust is quite at home. We see something similar in Scotland where the jurisprudence is derived from Roman law but because of its proximity to England – rather than the influence of Lord Kitchener in South Africa and Cecil Rhodes in former Rhodesia – has brought about the development of a trust law similar, although not identical, to the one in England.

But since the creation of Panama's first trust law Panamanians have passed (in 1995) a foundation law. Understandably, this civil law creature has found more regional favour than the Anglo-Saxon trust and has slowed down even further the rate of progress made by the trust in gaining mainstream acceptance in Panama. Reluctantly, and despite being a trust aficionado, I can see why the Panamanian foundation (with its codified, straightforward and simple law) rivals its Anglo-Saxon cousin.

Kings, Bishops and Businessmen

The roots of the English trust reach deep into the principles of equity. Centuries before the world heard the word, Seneca the Elder had identified the meaning of equity, expressing himself in a simple, but clear, way: "Certain laws have not been written but they are more fixed than all the written laws".

The eminent British judge, Lord Diplock, once said that the beauty of common law, which goes hand in hand with equity, was that it was a maze and not a motorway; if you cannot exit the maze, however, equity is there to help because it is concerned with finding solutions in cases where legal remedies are either unavailable or would be patently unfair if applied and could cause undue hardship.

Equity developed in feudal England in the King's Chapel which was charged with issuing official documents, such as royal writs. The original Chancellor, a state official, was, by the fourteenth century, a chief adviser to the King serving as the head of the affairs of state. His responsibility for issuing writs for use in the royal courts sometimes made him aware of the unfairness and failings of the common law and this would lead him to grant relief to a petitioner. During the fifteenth century this practice had evolved into a Court of Chancery

which would provide judicial relief to those who lost their way in Lord Diplock's maze.

The Chancellor was guided by his moral conscience and did not refer to previous legal decisions or rules. He followed the procedures of the ecclesiastical courts, which is not surprising, as he was not a lawyer but nearly always a senior clergyman, such as a bishop. Consequently, in the early stages of the court's development the Chancellor did not consider that he had any judicial jurisdiction, being independent of the courts of common law. It was the appointment of Lord Nottingham in 1673, however, that changed everything. He wanted the principles and rules of equity clearly defined and so precedents were established as was the subsequent practice of appointing a prominent lawyer as Lord Chancellor.

But despite its English heritage, the trust shares common ground with civil law systems. The civil law principle of unjust enrichment is akin to equity (although there remains a school of thought with reservations about this) and it was Lord Wright in the English case of Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd who recognised that "any civilised system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, that is to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep".

So English equity and unjust enrichment may be awkward bedfellows but there is no reason why practitioners in Panama cannot share a mutual understanding, if not a language, with those in other distant offshore centres.

Just before leaving London in 1979, ahead of going to the Cayman Islands (a time when offshore really meant offshore), I purchased a copy of The Modern Law of Trusts (Fourth Edition) by David B. Parker and Anthony R. Mellows. In their introduction the authors said that "since the trust was invented, no lawyer has been able to give a comprehensive service to his client without a thorough grasp of the subject". I would argue that no financial services provider – domestic or international – can do so either, regardless of his field, because the principles which the trust enshrines have equal application in all commercial endeavours, especially those involving companies and which, coincidentally, are so often one of the basic tools used in assembling an offshore structure. Despite the immense contribution made by Lord Nottingham, the fundamentals of equity illustrate that businessmen, not just bishops, can grasp its principles and that having done so, should apply them.

Why is it that Delaware has become a leading trust jurisdiction for non-residents? It is because its Court of Chancery (created in 1792) has never become trapped in a mire of either procedural technicalities or constraining legal doctrines; sadly, its inspiration, the High Court of Chancery in the United Kingdom, no longer exists. Delaware has remained, unlike many other US states, true to the primary purpose of a court of equity and in doing so has recognised the fiduciary duties of directors.

I am left in no doubt as to why Delaware (whose corporate law was the model for Panama's) is also the leading corporate domicile in the US. Seneca the Elder would approve.

Straight Lines and Octagons

My geometry teacher told the class that the shortest distance between two points was a straight line. Sometimes, however, the complexity of an offshore structure demands more than the simplicity of a straight line approach; but be sure that this is so before you construct an octagon.

This newsletter, year in and year out, has promoted the creed of simplicity and no more so than in the December, 1999, OPQ (Espresso, Cappuccino and Ab Initio); now we have jurisdictions offering trusts with features, as well as names, that are unique.

In the case of names they still have some way to go to rival a piece of grassland named Whorehouse Meadow. It is located in Harney (no, not Horny) county in Oregon in North America. An attempt in the 1960s to rename it Naughty Girl Meadow was unsuccessful. Similar attempts to rename the village of Dildo in Newfoundland, Canada, have so far failed also.

Innovation – whether in the field of trusts or not – can be both productive and destructive. The recent subprime mortgage disaster is a case in point of the octagonal approach to finance with the creation of complex debt instruments in support of disintegrating mortgages. This is a venture which John Maynard Keynes might have accused those

involved of being infused with "animal spirits and spontaneous optimism".

Two top ratings agencies who have been grading corporate bonds since, respectively, 1909 (Moody's Investors Service) and 1916 (Standard & Poor's) gave their blessing to these complicated debt instruments. It has been estimated that in the US about a fifth of all mortgages were taken out by borrowers who, at best, fell into the high-risk credit category. Furthermore, perhaps half those loans were written by companies that were practically unregulated; many of them asked the borrower for little or no documentation in support of stated income.

One joke doing the rounds has likened the fiasco to the Titanic disaster where, similarly, the downside was not immediately obvious and only a few wealthy people got out in time. Others, however, who were wiser, never got on board. These same people look at the stock market and understand that emotion, not economics, is the driving force; like Keynes they recognise that investment sentiment is fickle and fragile, sometimes turning on nothing more than man's "digestions and reactions to the weather".

As one fund manager put it, many investors (count me in) do not want complicated products (note the corresponding annihilation of some hedge funds during the debt débâcle). They look for bonds of companies whose products are easy to understand and have both straight-forward business plans and healthy cash flows. In October, McDonald's, the US fast-food chain, raised $1.5 billion in bonds with orders for the paper reaching $9 billion within one hour. Food for thought, indeed.

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Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.

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