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Law for Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth that Follows

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NOTE

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I. INTRODUCTION

Imagine the following example of a typical asset protection minded individual: a married man with children who has amassed a good deal of wealth as a successful surgeon. Like many high-net-worth professionals, he is worried about the potential of a lawsuit and the devastating effect it would have on his hard earned fortune.[1] With no known existing creditors, he transfers the majority of his assets into a trust created under the laws of the Cook Islands.[2] His only stated purpose for creating the trust is to preserve his family's fortune for the benefit of himself, his wife, and his children. Subsequently, he receives notice that his medical malpractice insurance will be canceled. As a result, he decides to switch to a lower risk practice area and gives up surgery to become a general practitioner.[3] However, even general medicine is not risk free; during the treatment of a patient he commits medical malpractice. The injured patient sues and receives a judgment award of $500,000 only to learn that almost all of the doctor's assets are located in an offshore trust.[4] Cook Islands law does not recognize U.S. judgments, so

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1. *See generally* Charles M. Bruce et al., *Protection of Assets Trusts: Fallout from Litigation Explosion*, N.Y. L. J., Sept. 13, 1991, at 1 (discussing the classic situation of a well-to-do settlor who feels at risk of a lawsuit perhaps because of lingering liability from a prior contract or the nature of his business).

2. The Cook Islands are located 1,900 miles off the coast of New Zealand. *See* Debra Baker, *Island Castaway*, A.B.A. J., Oct. 1998 at 54, 55 (explaining how offshore trusts can have the effect of defrauding the spouse of a settlor and leaving the spouse with no remedy).

3. This hypothetical is loosely based on facts found in a Florida case involving debtor-creditor rights. *See generally* Hurlbert v. Shackleton, 560 So. 2d 1276, 1277-78 (Fla. Dist. Ct. App. 1990). However, that case did not involve the use of an offshore trust. *See id.*

4. The rest of his assets are held in joint tenancy by the entireties with his wife and therefore not subject to satisfying the judgment.

the victim cannot enforce this judgment against the assets located in trust.[5]

Unlike most states in the United States, the Cook Islands do allow the creator of a trust to be a trust beneficiary and to exercise a certain degree of control over the disposition of the trust. This means that the doctor may receive payments of income from the same trust assets that are unavailable to satisfy the victim's judgment—essentially he gets the best of both worlds. This result seems unfair to the unsatisfied victim.

This outcome does not resonate well with what has traditionally been the well-settled principle of U.S. law that one should not be able to benefit from and control property that is inaccessible to his creditors. Nonetheless, two states have modeled their trust laws after this paradigm. Alaska and Delaware recently passed legislation that may make it possible for any U.S. citizen to set up a trust in the United States that achieves benefits previously attainable only through offshore trusts.[6]

For years, U.S. citizens have looked to offshore jurisdictions to create trusts that protect a settlor's assets from the claims of creditors, yet allow the settlor to be named as a beneficiary.[7] United States law and public policy have long been against the idea of allowing a person to enjoy benefits from assets that are simultaneously shielded from creditors' claims.[8] However, despite

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5. The only way the victim could reach the assets held in the offshore trust would be by relitigating his claim under the laws of the Cook Islands, a complicated and expensive proposition.

6. *See generally* Richard W. Hompesch II et al., *Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?*, J. ASSET PROTECTION, July/Aug. 1997, at 9. Proponents of the Alaska legislation claim that "self settled trusts can be created under a new Alaska law without subjecting the trust assets to claims of the grantor's future creditors." *Id.* *See also* Jonathan G. Blattmachr et al., *New Alaska Trust Act Provides Many Estate Planning Opportunities*, 24 EST. PLAN. 347, 347 (1997) (stating that the Alaska Trust Act "allows an individual to create in Alaska a trust from which the grantor can receive distributions . . . without exposing the trust to claims of the grantor's creditors"). Jonathan Blattmachr, co-author of both previously cited articles as well as many others championing the Alaska Trust Act and a partner in the New York law firm of Milbank, Tweed, Hadley & McCoy, assisted in drafting the new law. *See* Katharine Fraser, *With New Law, Alaska Aiming to Be Trust Capital*, AM. BANKER, Apr. 21, 1997, at 1. His brother, Douglas Blattmachr, chief executive officer of the Alaska Trust Co., lobbied to get the law passed by the Alaska legislature. *See* Brigid McMenamin, *Flimsy Shelters*, FORBES, Sept. 8, 1997, at 94.

7. *See* Lynn Asinof, *Protection of Offshore Trusts Comes Onshore in Two States*, WALL ST. J., July 23, 1997, at C1.

8. *See* RESTATEMENT (SECOND) OF TRUSTS § 156 (1959). The RESTATEMENT (SECOND) OF TRUSTS reads:

this existing public policy, Alaska and Delaware have enacted statutes that attempt to do just that.[9] Essentially, these statutes claim to make what used to be possible only offshore, now possible in the United States.

This Note seeks to show that regardless of whether the new legislation is effective in protecting assets from creditors, its *mere passage* seems to mark a break from long-standing U.S. public policy against self-settled spendthrift trusts.[10] This well-established policy, reflecting ideas of equity and fairness, dictates that debtors should use available resources to pay their debts.[11] This policy is most pronounced in situations where people are able to successfully shield their trust assets from such involuntary creditors as spouses, children, and tort victims. It seems that the Alaska and Delaware legislators may be willing to ignore what is fair to creditors in order to bring money into their states.[12] In fact, these legislators may be putting the interests of their respective states, as well as the interests of wealthy asset protectors, before the rights of creditors, previously held concepts of fairness, and what has been the prevailing law in this country. If estate planners and asset protectors elect to utilize trusts under these new statutes, Alaska and Delaware stand to be the depositories of massive amounts of wealth. This will translate into financial growth in each state through increased business

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(1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.
(2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply to his benefit.

Id.

9. *See* Hompesch et al., *supra* note 6, at 15 (claiming that "an individual is now able to create an Alaska trust of which he or she is a discretionary beneficiary that will be protected from his or her creditors").

10. One commentator, on the changing role of trust law, considers the Alaska and Delaware trusts one of many dramatic reforms reflecting a changed view of the relationship between creditors and trusts and the resulting rearrangement of creditors rights. *See* Joel C. Dobris, *Changes in the Role and the Form of the Trust at the New Millennium, or, We Don't Have to Think of England Anymore*, 62 ALB. L. REV. 543, 547, 555, 572 (1998).

11. *See* Karen Gebbia-Pinetti, *As Certain As Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law*, *in* SC60 ADVANCED ESTATE PLANNING TECHNIQUES 179, 213 (A.L.I.-A.B.A. Course of Study 1998) (providing a discussion of the reasons against using spendthrift trusts).

12. If these trusts become popular they will bring a boom to banks in the states that act as trustees and the states will benefit. *See* Fraser, *supra* note 6, at 1. Alaska State Representative Al Vezey, R-North Pole, the bill's sponsor, stated: "We are trying to be a business-friendly state; we want economic growth." *Id.*

among banks, attorneys, accountants, financial advisors, and any other professions that will assist clients in establishing and managing these trusts, the benefits of which will trickle down throughout each state's economy.[13]

Since asset protection is the primary reason U.S. citizens create offshore trusts, Part II of this Note explains the goals behind asset protection and how the self-settled spendthrift trust works to achieve these goals. The policy implications of self-settled spendthrift trusts will be discussed, as well as the differences between U.S. law and that of foreign jurisdictions. Part III examines the background and the structure of the Alaska and Delaware statutes. Part IV discusses the effectiveness of the new Alaska and Delaware trusts as asset protectors. This Note concludes with an analysis of the significance of the shift in U.S. public policy and a determination that the Alaska and Delaware statutes do not represent good policy.

II. THE SELF-SETTLED SPENDTHRIFT TRUST

Prior to the passage of the Alaska and Delaware legislation, estate planners and asset protection experts generally agreed that offshore asset protection trusts provided optimum creditor protection.[14] Certain offshore jurisdictions provide such protection because their laws allow and enforce self-settled spendthrift trusts, which, until recently, were generally not enforceable under U.S. law. United States public policy and state law made it impossible for a settlor to expressly create a trust in which assets are completely protected against creditors while allowing the settlor to maintain control and enjoyment of the assets. The Alaska and Delaware legislation attempts to change the existing law by allowing a settlor to create a trust which names the settlor as a beneficiary and includes a provision that protects the assets from the settlor's creditors, that will be enforced under their laws.[15]

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13. *See* discussion *infra* Part III.B.

14. *See* Elena Marty-Nelson, *Taxing Offshore Asset Protection Trusts: Icing on the Cake?*, 15 VA. TAX REV. 399, 412 (1996) [hereinafter Marty-Nelson, *Taxing Offshore*]; Elizabeth R. Turner & Kathryn G. Henkel, *Asset Protection Techniques, in* C992 ADVANCED ESTATE PLANNING TECHNIQUES 1, 42 (A.L.I.-A.B.A. Course of Study 1995); Philip R. Rupprecht & Jonathan P. Friedland, *Fallout from Portnoy: Is There Bankruptcy Protection in an Asset Protection Trust?*, BANKR. STRATEGIST, July 1997, at 1, *available in* LEXIS, NEWS Library, CURNWS File.

15. *See* ALASKA STAT. § 34.40.110 (Lexis 1998); DEL. CODE ANN. tit.12 §§ 3570-76 (Supp. 1998). A trust is defined as "a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held

A. *The Goal of Asset Protection and the Tools Used to Achieve It*

Individuals generally seek to accomplish one or more of the following goals when ordering their finances so as to provide for themselves and their families during life as well as upon death: estate planning, financial planning, and asset protection.[16] The main goal of estate planning is to ensure that upon a client's death his property passes smoothly and in accordance with his intentions to the people or entities that he wants to receive portions of his estate.[17] In addition, estate planning seeks to protect the estate from probate, a costly and time-consuming process, and to minimize tax liability.[18] Financial planning seeks to achieve a balance between risk and reward in order to maximize an estate's growth.[19] Asset protection planning aims to organize one's assets in such a way so as to safeguard them from loss that could otherwise result from their exposure to potential creditors.[20]

Asset protection planning generally seeks to preserve and protect one's estate during one's lifetime as well as after death.[21] Interest in asset protection planning has increased as a result of the financial uncertainties facing a businessperson, a professional, an entrepreneur, or a property owner in the United States today.[22] Various economic and social factors have caused many financially successful people to feel their wealth is at risk, which has led them to utilize asset protection strategies to safeguard their wealth.[23] Expanding theories of legal liability,[24]

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to equitable duties to deal with the property for the benefit of another person." RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

16. *See* Barry S. Engel, *Using Foreign Situs Trusts for Asset Protection Planning*, 20 EST. PLAN. 212, 212 (1993). For the purposes of this Note, the analysis is limited to trusts established by "U.S. persons" as that term is defined in I.R.C. section 7701(a)(30). That provision defines the term "U.S. person" as "(A) a citizen or resident of the United States, (B) a domestic partnership, (C) a domestic corporation, [and] (D) any estate or trust (other than a foreign estate or foreign trust within the meaning of [§ 7701(a)](31))." I.R.C. § 7701(a)(30) (Supp. II 1996). This Note does not address issues relating to a non-resident alien of the United States establishing a foreign trust for the benefit of U.S. beneficiaries.

17. *See* Engel, *supra* note 16, at 212.

18. *See id.*

19. *See id.*

20. *See id.* The term asset protection can be defined very broadly to include any type of financial planning that has the effect of reducing taxes or preserving assets. *See* Gebbia-Pinetti, *supra* note 11, at 209. However, the term is more often used when protecting one's assets is a motive for a transaction, as opposed to just an incidental effect. *See id.*

21. *See* Engel, *supra* note 16, at 212.

22. *See id.* at 212-13.

23. *See id.*

result-oriented judges, juries willing to disregard precedent, unpredictably high damage awards, and the unavailability of adequate insurance coverage are some of the factors that have lead to an increased demand for asset protection planning.[25]

Asset protection devices serve not only to protect a wealthy client's assets against an unfavorable judgment, but also to reduce the risk that a client will be sued in the first place.[26] Successful professionals and any other high-net-worth individuals that appear to have deep pockets are often last resorts for plaintiffs looking to compensate a loss.[27] Some believe that wealth alone can be an incentive for claimants to file suits. Therefore, protecting one's assets can dissuade claims from being made and also provide incentive for settlements more favorable to a wealthy defendant.[28]

There are many different methods that can be used to protect assets.[29] These methods offer varying degrees of protection from creditors. The amount of protection provided depends upon the device chosen, how it is structured, applicable state law, and the particular client's situation and goals.[30] Some of the various asset protection planning tools include limited partnerships and family limited partnerships,[31] custodial accounts, joint ownership of assets between spouses,[32] domestic trusts, offshore trusts, outright gifts, incorporating assets, and investment in tax exempt assets.[33] However, steps to protect assets must be taken, regardless of what device is employed, prior to the existence of

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24. Such liability may include tort liability stemming from professional practice, or liability to creditors arising from loans or other financial transactions necessary for financing personal or business affairs. *See* William D. Lipkind & Elizabeth Gasser, *Protecting Assets from Creditors; High Net Worth: The Accoutrements of Success*, CPA JOURNAL, Sept. 1993, at 18, 18.

25. *See* Jon Newberry, *Protect Assets Before Lawsuit Arises: Financial Planning Can Help Preserve Profits, Dissuade Claimants*, 82 A.B.A. J., Jan. 1996, at 89, 89.

26. *See id.*

27. *See* Lipkind & Gasser, *supra* note 24, at 18.

28. *See id.*

29. *See generally* Engel, *supra* note 16, at 213-14.

30. *See generally* Brad Burg, *Moves to Make Before You're Sued; 1996 Financial Planning Guide*, MEDICAL ECON., Nov. 13, 1995, at 57.

31. *See* Engel, *supra* note 16, at 213-14 (discussing the advantages and disadvantages of using limited partnerships as a means of protecting assets). *See also* Turner & Henkel, *supra* note 14, at 44-78 (providing an in-depth analysis of the use of family limited partnerships as an asset protection method).

32. *See* Burg, *supra* note 30, at 62-69, for a discussion regarding the pros and cons of these asset protection methods.

33. *See generally* Turner & Henkel, *supra* note 14, at 28-80 (for a detailed discussion of these asset protection tools).

any known or expected creditor or claimant.[34] Otherwise, the transfer may be deemed fraudulent and void with respect to creditors.[35]

B. *The Optimum Asset Protector—The Self-Settled Spendthrift Trust*

Transferring assets into a trust can have the primary or incidental effect of removing them from the reach of the settlor's creditors, thus protecting the assets.[36] Ensuring the financial security of the trust beneficiaries for the duration of the trust is a fundamental purpose of virtually all trusts.[37] There are many different types of trusts that offer varying degrees of asset protection.[38] However, there are certain protective mechanisms that are frequently incorporated into trust instruments in an effort to defeat creditor access to trust holdings.[39] A trust may contain a spendthrift or a forfeiture clause. Such clauses restrict a beneficiary's access to trust assets, which has the effect of also restricting the beneficiary's creditors from the trust funds.[40] In addition, the beneficiary's interest in the trust may be conditioned upon a certain standard, as in a support trust, or be subject to the trustee's discretion, thereby creating a discretionary trust.[41]

1. What is a "Self-Settled Spendthrift Trust"?

Trusts intended to remove assets from the reach of the settlor's creditors are often referred to as "asset-protection trusts."[42] The prevailing opinion among estate planners and asset protection experts is that self-settled spendthrift trusts offer

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34. *See* William D. Zabel & Kim E. Baptiste, *Asset Protection and Estate Planning: Three Scenarios*, TR. & EST., Nov. 1995, at 54, 56-57.

35. *See id.*

36. *See* Gebbia-Pinetti, *supra* note 11, at 185. There are also other asset protection methods available, such as family gift giving, taking advantage of various creditor exemptions available under states' laws, and family limited partnerships. *See* Engel, *supra* note 16, at 213.

37. *See* Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 17 (1994) [hereinafter Marty-Nelson, *Asset Protection Trusts*]. The analysis in this Note does not encompass offshore trusts used to evade income taxes illegally.

38. Trusts serve many purposes other than asset protection including estate planning, reducing taxes, and avoiding probate. *See id.* at 17 n.31.

39. *See id.* at 17.

40. *See id.*

41. *See id.*

42. *See* Gebbia-Pinetti, *supra* note 11, at 185.

the settlor the greatest amount of asset protection.[43] To create this ideal trust a settlor transfers his assets into trust, names himself as a beneficiary, includes a provision that the trust holdings may not be voluntarily or involuntarily alienated prior to distribution, and appoints as trustee either himself or a third party over whom he retains certain powers.[44] Such a trust construction has the effect of shielding the trust funds from the settlor's creditors while still allowing the settlor to receive income as a beneficiary and exercise some control over the management of the trust.

A spendthrift trust in its truest form requires mandatory distributions and provides in the trust instrument that the beneficiaries can neither voluntarily nor involuntarily alienate their interests and that their creditors cannot reach the trust's assets.[45] Simply placing a provision in the instrument that restrains the beneficiaries and their creditors from enjoying rights to the trust's assets creates such a trust.[46]

Initially, settlors desiring to insulate trust assets for the benefit of a financially irresponsible beneficiary used spendthrift trusts.[47] However, spendthrift trusts were soon commonly used

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43. *See id.* at 211. *See also* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 415 n.85 (noting that offshore jurisdictions are usually chosen "to obtain maximum protection against potential future creditors").

44. *See* Gebbia-Pinetti, *supra* note 11, at 211. Retained powers over the trustee could include the power to appoint and terminate trustees or the power to veto distributions. *See id.*

45. JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUSTS, & ESTATES 631 (5th ed. 1995). A spendthrift trust is one "in which the interest of a beneficiary cannot be assigned by him or reached by his creditors." 2A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS, § 151, at 83 (4th ed. 1987).

46. *See* DUKEMINIER & JOHANSON, *supra* note 45, at 631. An example of a spendthrift provision would be:

> Each beneficiary hereunder is hereby restrained from alienating, anticipating, encumbering, or in any manner assigning his or her interest or estate, either in principal or income, and is without power so to do, nor shall such interest or estate be subject to his or her liabilities or obligations nor to judgment or other legal process, bankruptcy proceedings or claims of creditors or others.

Shelly v. Shelly, 354 P.2d 282, 284 (Or. 1960).

47. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 19. Spendthrift trusts gained legal recognition as a result of dicta in *Nichols v. Eaton* that stated:

> Why a parent, or one who loves another, and wishes to use his own property in securing the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived.

to protect responsible beneficiaries from their potential creditors.[48] The spendthrift trust, when set up for the benefit of someone other than the settlor, is recognized and enforced in almost all jurisdictions either under common law doctrine or by statute.[49]

Spendthrift trusts are enforced against creditors of a beneficiary other than the settlor on the theory that as absolute owner of property a settlor may dispose of that property as he wishes.[50] Once a settlor places assets in a spendthrift trust, the trustee is the legal owner of the property and the beneficiaries own an equitable interest in the trust until such time as assets are distributed.[51] Courts reason that enforcing spendthrift trusts does not thwart public policy unless the effect is fraud upon creditors.[52] They further justify the enforcement of spendthrift provisions by concluding that creditors can avoid being defrauded, because they are able to determine if a trust beneficiary's interest is limited by a spendthrift clause prior to entering into a transaction.[53] Once the creditor learns that the beneficiary's interest in trust is restricted by a spendthrift provision he can either bargain for increased protection or simply choose not to deal with the beneficiary.[54]

Of course, this reasoning does not apply to all types of creditors. In fact, this reasoning assumes that all creditors enter into transactions with trust beneficiaries voluntarily, and ignores the existence of involuntary creditors, who are also called "special claimants."[55] Such claimants include children, spouses, or tort victims to whom the settlor may owe legitimate debts; none of these claimants had the opportunity to choose their role as a

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Nichols v. Eaton, 91 U.S. 716, 727 (1875). Then in *Broadway National Bank v. Adams*, the court upheld the validity of the spendthrift trust. 133 Mass. 170 (1882). This is considered the seminal case in establishing spendthrift trusts. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 11 n.2.

48. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 19. See Nancy S. Roush & Robert K. Kirkland, *Spendthrift Trusts Not Limited to Protection of Immature Dependents*, 18 EST. PLAN. 16, 17 (1991) (suggesting spendthrift trusts are routinely used to protect responsible beneficiaries).

49. *See* DUKEMINIER & JOHANSON, *supra* note 45, at 632. By statute New York recognizes all trusts as spendthrift unless the beneficiary's interest is expressly transferable. *See* N.Y. EST., POWERS & TR. LAW § 7-1.5 (McKinney 1992).

50. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 20; *Broadway Nat'l Bank*, 133 Mass. at 173.

51. *See* Gebbia-Pinetti, *supra* note 11, at 211.

52. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 20; *Broadway Nat'l Bank*, 133 Mass. at 173.

53. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 20. *Broadway Nat'l Bank*, 133 Mass. at 173.

54. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 20.

55. *See id.* at 20-21 & n.50.

creditor of the settlor.[56] This class of claimants receives special treatment under some states' laws with respect to access to spendthrift trusts.[57]

If a court enforces a trust's spendthrift clause, then the beneficiary's interest in the trust is not available to satisfy the claims of the beneficiary's creditors.[58] Thus, a creditor cannot gain access to the trust assets by attachment, garnishment, or other legal process.[59] However, once money from the trust is distributed to the beneficiary, the funds are no longer protected and are subject to creditors' claims.[60]

2. The Controversial Nature of Spendthrift Trusts

The inclusion of spendthrift clauses in trusts has been a controversial issue since these clauses were first recognized and enforced by the courts.[61] Compelling arguments have been made both for and against their validity. Some question the appropriateness of protecting trust beneficiaries from their financial obligations.[62] Why should a debtor not be made to pay his legitimate debts just because of a trust provision? Spendthrift provisions may have a detrimental effect upon society in that they allow the financially irresponsible to continue to be irresponsible and wasteful, and they are misleading as they have the potential to defraud unsuspecting creditors.[63] In addition, spendthrift trusts give beneficiaries a disincentive to carry insurance, exercise care in dealings with creditors, and take precautions to avoid a tort judgment.[64]

Conversely, those in support of spendthrift clauses argue that the settlor of a trust for the benefit of another should be able

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56. *See generally id.* at 43-46.

57. *See id.* at 40 n.138, 46.

58. *See id.* at 22.

59. *See id. See also* PETER A. ALCES, THE LAW OF FRAUDULENT TRANSACTIONS, ¶ 1.01[2][a] (1989) (discussing the legal remedies generally available to creditors).

60. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 22.

61. *See generally* Anne S. Emanuel, *Spendthrift Trusts: Its Time to Codify the Compromise*, 72 NEB. L. REV. 179 (1993) (explaining both sides of the debate over the appropriateness of including spendthrift provisions in trusts); Broadway Nat'l Bank v. Adams, 133 Mass. 170 (1882) (validating the spendthrift trust).

62. *See* Gebbia-Pinetti, *supra* note 11, at 211.

63. *See* GEORGE T. BOGERT, HANDBOOK OF THE LAW OF TRUSTS, 149 (5th ed. 1973). Two other arguments against spendthrift trusts include: (1) equitable life or fee interests are inherently alienable so a clause prohibiting the transfer of equitable interests is against their nature, and (2) legal estates for life or in fee cannot be encumbered by restrictions on alienability and there is no reason that is should not be the same for equitable interests. These arguments have more to do with policy regarding property. *See id.*

64. *See* Gebbia-Pinetti, *supra* note 11, at 213.

to attach to it such restrictions.[65] Moreover, they argue that spendthrift trusts are valuable in providing for and protecting unknowledgeable and incompetent beneficiaries.[66] Furthermore, proponents of these trusts maintain that the trusts do not have the effect of defrauding creditors because creditors can inquire into a beneficiary's source of income, get a credit report, or condition the giving of credit upon a statement of assets.[67]

The controversy regarding spendthrift trusts increases when the settlor of such a trust names himself as a beneficiary, thereby creating a self-settled spendthrift trust. This type of trust is considered the ultimate in asset protection devices because it allows the settlor to retain an interest in and even control over the trust, receive distributions as a beneficiary, and yet shield the assets from the claims of his creditors.[68] Advocates of self-settled spendthrift trusts argue that they are necessary tools to combat the explosion of litigation and legal liability that has occurred in this country.[69] They argue that those with wealth are more likely to be the targets of unscrupulous lawsuits and that asset protection devices, such as the spendthrift trust, are necessary to protect their assets for themselves and their families.[70] In a climate where deep pockets are thought to attract lawsuits, spendthrift trusts offer a form of counter-leverage against unwarranted litigation.[71] This deterrent effect reduces not only the threat of groundless suits, but also saves the costs of defending against such litigation and the extorted settlements that often result.[72]

However, there are compelling arguments against the propriety of self-settled spendthrift trusts. Most of the arguments in favor of these instruments ignore the effects of such trusts on involuntary creditors.[73] While it is true that commercial lender creditors generally have the chance to investigate and bargain up front with the debtor, involuntary creditors have no such

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65. *See* BOGERT, *supra* note 63, at 149.

66. *See id.*

67. *See id.* Additional arguments in favor of spendthrift trusts are that a restriction on the alienability of trust property is not undesirable since the trustee can usually sell it free of the trusts even though the beneficiary cannot transfer his interest. *See id.* Bogert makes the point that creditors also have the option of collecting from the beneficiary over time by taking the income after it has been distributed. *See id.*

68. *See* Gebbia-Pinetti, *supra* note 11, at 207-08.

69. *See* Gideon Rothschild, *Establishing and Drafting Offshore Asset Protection Trusts*, 23 EST. PLAN. 65, 65 (1996); Engel, *supra* note 16, at 212.

70. *See* Rothschild, *supra* note 69, at 65-66.

71. *See id.* at 65.

72. *See id.*

73. *See generally* Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 77 (1995).

opportunity.[74] Tort victims, and spouses and children of settlors do not have the benefit of selecting, investigating, or bargaining with the settlor before becoming creditors.[75] In particular, tort victims and children of the settlor are not able to avoid contact with the beneficiary.[76]

Just as one can avoid legitimate debt by careful dealings when borrowing money or contracting for services, one can also avoid tort judgments by exercising appropriate care. Also, those professionals who are subject to malpractice claims can purchase insurance to protect against lawsuits.[77] Such protective measures would reduce the need for use of the self-settled spendthrift trust. Alternatively, a potentially negative societal effect of the use of self-settled spendthrift trusts is that it gives the settlor little incentive to exercise an appropriate standard of care in his dealings with others or to purchase insurance.[78] In addition, the assertion that asset protection trusts are necessary to combat the threat of illegitimate claims undermines the entire U.S. justice system.[79] This argument assumes a wealthy defendant will not be treated fairly in the system merely because he is wealthy.[80]

C. *The United States v. Foreign Jurisdictions: Differing Legal Approaches to Self-Settled Spendthrift Trusts*

Up until the passage of the Alaska and Delaware statutes, it was the rule in most states that a settlor's creditors could reach assets in self-settled trusts, regardless of whether the trust instrument contained a spendthrift provision.[81] This treatment of domestic self-settled spendthrift trusts under traditional state law reflects what has been the prevailing policy in the United States—*it is unjust to allow an individual to simultaneously shield assets*

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74. *See id.*

75. *See id.* Arguably, alimony creditors are in fact voluntary since they presumably entered into marriage willingly. *See* WILLIAM M. MCGOVERN, JR. ET AL., WILLS, TRUSTS AND ESTATES § 8.7, at 345-46 (1988). For a discussion of the weakness of the contract analogy to the marriage relationship, see Ira M. Ellman, *The Theory of Alimony*, 77 CAL. L. REV. 1, 13-33 (1989).

76. *See* Gebbia-Pinetti, *supra* note 11, at 213. *See also* Laurene M. Brooks, Comment, *A Tort-Creditor Exception to the Spendthrift Trust Doctrine: A Call to the Wisconsin Legislature*, 73 MARQ. L. REV. 109, 126 (1989) (making the point that one who is about to get hit by an automobile "has no opportunity to investigate the credit of the driver of the automobile and has no opportunity to avoid being injured no matter what the resources of the driver may be").

77. *See* Gebbia-Pinetti, *supra* note 11, at 213.

78. *See id.*

79. *See id.*

80. *See id.* (noting that a wealthy defendant can countersue for malicious prosecution).

81. *See infra* discussion Part III.C.1.

and enjoy benefit or control over them.[82] Because of this policy, states uniformly outlawed self-settled spendthrift trusts either by statute or judicially developed common law.[83] As a result, offshore trusts were used as asset protection vehicles since certain foreign jurisdictions allow a settlor to be a trust beneficiary while protecting the trust against the claims of the settlor's creditors.

1. The U.S. Approach: Outlawing the Self-Settled Spendthrift Trust

United States courts will generally enforce spendthrift trusts that are created by the settlor for the benefit of a third party. However, there are several exceptions to this practice.[84] In most cases, judgments for child support or alimony can be enforced against the debtor's interest in a spendthrift trust.[85] In addition, one who provides necessary services or support for the beneficiary of a spendthrift trust can usually reach trust assets.[86] Under these circumstances, courts and legislatures have recognized that it would be unfair and unjust to protect a beneficiary's interest in a spendthrift trust to the detriment of certain kinds of creditors.

Significant legal obstacles exist in the United States to limit the ability of settlors to use trusts to shield their assets from creditors.[87] Namely, common law rules or statutes exist in almost every state, which permit a settlor's creditors to satisfy their claims by accessing trust assets where the settlor is also a beneficiary.[88] Such rules and statutes essentially refuse to

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82. *See* RESTATEMENT (SECOND) OF TRUSTS § 156 (1959); *see also* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 14.

83. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 30 n.95 for a list of states with statutes specifically addressing spendthrift provisions in self-settled trusts. States without statutes specifically addressing self-settled spendthrift trusts often achieve the same results through judicially produced common law. *See id.* at 31.

84. *See* DUKEMINIER & JOHANSON, *supra* note 45, at 638.

85. *See, e.g.*, Shelley v. Shelley, 354 P.2d 282, 286-88 (Or. 1960) (holding that a beneficiary's interest in a spendthrift trust may be reached for alimony and child support claims based on a strong public policy rationale).

86. *See* 2A SCOTT & FRATCHER, *supra* note 45, §`157.2, at 201.

87. *See* DUKEMINIER & JOHANSON, *supra* note 45, at 638; Gebbia-Pinetti, *supra* note 11, at 185.

88. *See* 2A SCOTT & FRATCHER, *supra* note 45, § 156, at 168-69. Many states have codified the rule presented in the RESTATEMENT (SECOND) OF TRUSTS regarding self-settled spendthrift trusts. *See* Gideon Rothschild, *Asset Protection Issues that Arise in Estate Planning*, *in* BASIC ESTATE PLANNING 243, 262 (PLI Est. Plan. & Admin. Course Handbook Series No. D-254 1997). New York, for example, enacted a statute stating that a disposition in trust for the use of the settlor is void as against existing or subsequent creditors of the settlor. *See* N.Y. EST.

enforce the settlor's attempt to shield his assets by ignoring the trust's spendthrift provision as applied to the settlor.[89]

Furthermore, fraudulent transfer laws, which exist in some form in every state, prohibit a debtor from transferring his assets with the intent to hinder, delay, or defraud creditors.[90] In some states a transfer by a debtor may be deemed fraudulent if it has the effect of reducing his available assets to the detriment of his creditors, even if he has no actual intent to defraud.[91] Any type of transfer may be found to be fraudulent, if it meets this intent or effect criteria, whether it is an outright gift to a family member or a transfer into trust.[92] However, a transfer into a trust in which the debtor-settlor retains any right to assets that he claims are not available to creditors is more likely to be suspect as a fraudulent conveyance.[93] Where a transfer is found to be fraudulent a court will deem the transfer void, and the creditor may recoup the amount he is owed.[94]

Courts in almost all states except Alaska and Delaware refuse to enforce a spendthrift trust against a settlor's creditors where the trust is set up by the settlor for the settlor's own benefit—in other words, a self-settled spendthrift trust.[95] In a mandatory distribution self-settled trust, the creditors of the settlor can reach all of the settlor's interest in the trust.[96] In a discretionary self-settled trust, creditors can reach the maximum amount that the trustee, in his discretion, could pay the settlor as beneficiary.[97] When a settlor names himself as a trust beneficiary, under state law the settlor's creditors can reach the trust assets.[98] Most states have adopted the rule of the Restatement (Second) of Trusts which explains that "[w]here a person creates for his own benefit a trust for support or a

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POWERS & TR. LAW § 7-3.1 (McKinney 1992). Setting aside such a transfer does not require proof of either intent to defraud or insolvency. See Vanderbilt Credit Corp. v. Chase Manhattan Bank, 473 N.Y.S.2d 242, 245 (N.Y. App. Div. 1984).

89. *See infra* note 106 and accompanying text.

90. Some states have adopted uniform statutory provisions, or similar variations, such as the Uniform Fraudulent Conveyance Act (UFCA) and Uniform Fraudulent Transfer Act ("UFTA"), while others deal with fraudulent conveyances as a matter of common law. *See* ALCES, *supra* note 59, ¶ 1.02[1][b].

91. *See* Gebbia-Pinetti, *supra* note 11, at 185.

92. Courts may be suspicious of gratuitous interfamilial transfers and have even taken the position that they are presumptively fraudulent. *See* ALCES, *supra* note 59, ¶ 1.02[1][b].

93. *See* Gebbia-Pinetti, *supra* note 11, at 185.

94. *See* ALCES, *supra* note 59, ¶ 1.01[2].

95. *See* DUKEMINIER & JOHANSON, *supra* note 45, at 638.

96. *See id.*

97. *Id. See* 2A SCOTT & FRATCHER, *supra* note 45, § 156.2, at 175.

98. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 430. *See, e.g., In re* Shurley, 171 B.R. 769 (Bankr. W.D. Tex. 1994).

discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit."[99] This rule furthers the principle that it is unfair to allow a person to arrange his property in such a way that he can enjoy it while preventing his creditors from reaching it.[100]

The question of whether a creditor can access a settlor's assets held in a self-settled spendthrift trust may arise in the U.S. legal system in various ways. In a "genuine" creditor case a creditor is a party in the lawsuit seeking access to trust assets in order to satisfy a debt.[101] Alternatively, the issue could be addressed in tax cases in which there is no actual creditor seeking satisfaction of a claim, but the issue of creditor access determines the estate and gift tax consequences of the trust to the settlor.[102]

Many states have adopted the Restatement rule regarding creditor access, thereby reinforcing the rule that creditors can reach self-settled spendthrift trusts.[103] New York courts, allowing creditor access to self-settled discretionary trusts, specifically adopt the Restatement's position and allow invasion of the trust corpus even in situations in which the settlor is not the only trust beneficiary.[104] Similarly, under Texas law it is clear that creditors have access to self-settled trusts.[105] By statute Texas law expressly states that "a provision restraining the voluntary or involuntary transfer" of the interest of a settlor who is also a beneficiary, "does not prevent his creditors from satisfying claims from his interest in the trust."[106] In applying this statute, one Texas court noted the underlying policy that self-settled spendthrift or discretionary trusts are invalid.[107] Likewise, courts have held that under Hawaii law a settlor's creditors may reach the entire

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99. RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959).

100. *See* 2A SCOTT & FRATCHER, *supra* note 45, § 156, at 167.

101. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 431.

102. *See id.*

103. *See id.*

104. *See id. See, e.g.*, State v. Coyle, 575 N.Y.S.2d 975, 976-77 (N.Y. App. Div. 1991); State v. Hawes, 564 N.Y.S.2d 637, 638-39 (N.Y. App. Div. 1991); Vanderbilt Credit Corp. v. Chase Manhattan Bank, 473 N.Y.S.2d 242, 245 (N.Y. App. Div. 1984).

105. Texas has adopted the RESTATEMENT rule. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 432. *See In re* Shurley, 171 B.R. at 769, 769 (Bankr. W.D. Tex. 1994).

106. TEX. PROP. CODE ANN. § 112.035(d) (West 1995).

107. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 432-33; *see also In re Shurley*, 171 B.R. at 781.

trust corpus, if the trustee has absolute discretion to pay income to either the settlor or to other beneficiaries.[108]

Tax cases interpreting creditor access laws also follow the Restatement's position.[109] Most recent tax decisions have held that when a settlor includes himself among the class of beneficiaries in a discretionary trust, the settlor's creditors can reach trust assets regardless of any spendthrift provision.[110] These opinions are based on analysis of the local law that applies to the case.[111]

The prevailing opinion among estate planners and asset protection experts has consistently been that the self-settled spendthrift trust offers a settlor the greatest amount of asset protection available.[112] However, up until the recently enacted Alaska and Delaware legislation, this type of trust has been deemed to be against public policy in the United States.[113] Therefore, U.S. courts have refused to enforce the creditor protection provisions expressly stated in self-settled trusts and have allowed creditor access to assets held in self-settled spendthrift trusts.[114] As a result, U.S. citizens seeking asset protection through the use of self-settled spendthrift trusts have been forced to go to offshore jurisdictions.[115]

2. Foreign Jurisdictions: Not Only Are Self-Settled Spendthrift Trusts Legal, They Are Encouraged

Offshore asset protection trusts are created under the laws of foreign jurisdictions typically with the purpose of shielding assets from current or future creditors.[116] Various foreign jurisdictions have enacted legislation that favors the creation of such trusts by making it very difficult for creditors to gain access to the trust's

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108. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 433; *see also* Altman v. Commissioner, 83 B.R. 35 (D. Haw. 1988).

109. *See* Marty-Nelson, *Taxing Offshore*, *supra* note 14, at 434-35.

110. *See id.* at 435.

111. *See id.*

112. *See id.* at 415 n.85 (noting that offshore jurisdictions are usually chosen "to obtain maximum protection against potential future creditors"). *See also* Gebbia-Pinetti, *supra* note 11, at 211.

113. *See* RESTATEMENT (SECOND) OF TRUSTS § 156 (1959).

114. *See supra* notes 104-110 and accompanying text.

115. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 62 (stating that the use of offshore asset protection trusts are a solution to the U.S. rule of law regarding self-settled spendthrift trusts).

116. *See id.* at 12. Such trusts may be referred to as "OAPTs" (Offshore Asset Protection Trusts), "FAPTs" (Foreign Asset Protection Trusts), "IOEPTs" (International Offshore Estate Planning Trusts), and "global protection trusts." *See* Hompesch et al., *supra* note 6, at 9; Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 12.

assets.[117] Such foreign legislation can provide virtually impenetrable barriers against creditors seeking access to trust assets.[118]

Although offshore trusts may take a variety of forms, those geared toward asset protection, tend to have certain common characteristics.[119] Once formed, the trust is irrevocable.[120] The beneficiaries of the trust are generally the settlor's family members, particularly the spouse and children, and will also include the settlor himself.[121] The trustee is typically a foreign trust company or financial institution.[122] Possibilities for the duration of the trust include: a relatively short period of time with a reversionary interest in the settlor, a longer term tied to the lives of the settlor or beneficiaries, or the maximum number of years allowed by the offshore jurisdiction.[123] The trust instrument usually vests the trustee with unfettered discretion over the distribution of income and principal among the beneficiaries.[124] However, the settlor often reserves some measure of control over the trust's management.[125]

This typical offshore trust structure was thought to be desirable because it offered greater protection against creditors than any U.S. trust and it achieved this protection without the settlor having to give up total control over the trust's assets.[126] There are also tax consequences that follow from this protection against creditors.[127] A settlor's gross estate, for the purposes of

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117. *See* Engel, *supra* note 16, at 215-16. Foreign jurisdictions commonly chosen include the Bahamas, Belize, Cyprus, the Turks and Caicos Islands, the Cayman Islands, the Cook Islands, Isle of Man, and Gibraltar. *See id.*

118. *See* Marty-Nelson, *Taxing Offshore, supra* note 14, at 402.

119. *See id.* at 404.

120. *See* Lynn R. Saidenberg, *Estate Planning and Creditors' Rights, in* UNDERSTANDING BASIC ESTATE PLANNING 81, 100 (PLI Tax Law & Est. Plan. Course Handbook Series No. 223, 1993).

121. *See id.*

122. *See* Bruce et al., *supra* note 1, at 1.

123. *See* Marty-Nelson, Taxing Offshore, *supra* note 14, at 405.

124. *See* Saidenberg, *supra* note 120, at 100.

125. *See* Marty-Nelson, *Asset Protection Trusts, supra* note 37, at 13. The settlor may be a member of a "committee of advisors" that advises the trustee on the management of the trust. *See* Richard S. Amari, *Asset Protection Trusts: Nuclear Bomb Shelter*, FLA. B. J., July-Aug. 1992, at 17-19. However, the trustee should be able to ignore the advice of the committee, so that the committee does not have legal control over the trust administration. *See id.* The settlor could instead self-designate himself as "protector" of the trust with authority to replace the trustee. *See* Saidenberg, *supra* note 120, at 100. Often the settlor provides the foreign trustee with a "letter of wishes" that is non-binding and describes the settlor's preferences regarding the trust's distribution. *See* Samuel H. Okoshken, *Artful Structuring of an Offshore Trust*, INT'L HERALD TRIB.(Neuilly-sur-Seine, Fr.), May 29, 1993, at 248, available in LEXIS, NEWS Library, CURNWS File.

126. *See* Marty-Nelson, *Asset Protection Trusts, supra* note 37, at 13.

127. *See* Marty-Nelson, *Taxing Offshore, supra* note 14, at 402.

computing tax liability, excludes trust assets if these assets are successfully shielded from creditor access.[128] The transferor's gross estate includes assets transferred into the trust, if creditors can gain access to them.[129] This exclusion often cannot be achieved with certainty in domestic trusts due to their vulnerable position in relation to creditors.[130] As a result of these differences, it is argued that offshore trusts also offer tax advantages not attainable in U.S. trusts, thereby increasing the allure of foreign jurisdictions.[131]

Despite this potential tax benefit, asset protection is the primary reason people look to foreign jurisdictions to establish trusts.[132] The use of offshore trusts has increased among Americans in recent years.[133] Formerly, only the extremely wealthy utilized the offshore trust as an asset protection or estate-planning device.[134] However, the use of offshore trusts has increased with the demand for effective means of asset protection resulting from the perceived proliferation of personal liability in this country.[135] Offshore trusts have become popular among professionals who consider themselves to be vulnerable to malpractice claims, such as doctors, lawyers, or accountants, and company officers or directors who could potentially face environmental tort liability.[136] These businesspeople and professionals seek to shield their assets from the potentially devastating effects of litigation through the use of offshore trusts.[137]

Offshore trusts, created in jurisdictions with favorable asset protection laws, offer unique security to those who seek to ensure that their assets are out of the reach of current or future creditors. Prior to the passage of the Alaska and Delaware legislation, the consensus among experts in the field of trusts and estates was that an offshore asset protection trust offered the maximum amount of creditor protection.[138]

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128. *See id.*

129. *See id.*

130. *See id.*

131. *See id.* However, greater protection against creditors is the more common reason for establishing a trust in an offshore jurisdiction. *See* Saidenberg, *supra* note 120, at 99.

132. *See* Saidenburg, *supra* note 120, at 99.

133. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 14.

134. *See id.*

135. *See id.* at 56-57.

136. *See id.* at 14. *See also Smart Move*, TIMES (London), Nov. 12, 1991, at 29 (identifying professionals who are at high risk of malpractice suits).

137. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 14.

138. *See* Engel, *supra* note 16, at 215-15. Barry S. Engel is an attorney and specialist in asset protection planning. *See id.* at 212. He is also President of the

Another reason offshore trusts are so popular is that they allow settlors to retain a certain level of control over the property transferred into trust, which has not been possible under traditional domestic trust law.[139] It is often the case that those who are concerned with asset protection do not like the idea of surrendering control of their assets to a trustee.[140] However, relinquishing control has been a necessary element in forming a domestic trust that will serve to protect assets. If the settlor maintains control over a domestic trust, then under the laws of most states the trust is subject to creditors' claims against the settlor. Creditors against the settlor can reach trust assets to the extent that the settlor is entitled or eligible to receive them. Thus, there are substantial trade-offs to be considered when deciding between an offshore and domestic trust vehicle.

Offshore trusts often defeat principles that are entrenched in U.S. trust law.[141] Namely, the principle that one should not be able to control and benefit from property that is shielded from one's creditors, a principle upheld in most states through statutory or common law.[142] The use of offshore trusts bypasses these state laws that prohibit self-settled spendthrift trusts and allow settlors to reap the asset protection benefits of self-settled spendthrift trusts.

III. ALASKA AND DELAWARE TRY TO COMPETE WITH FOREIGN JURISDICTIONS

Alaska and Delaware recently enacted legislation that purports to make it possible for residents of any state to create self-settled spendthrift trusts.[143] They claim to allow settlors to

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Offshore Institute and has helped write trust legislation for a foreign jurisdiction. *See id.*

139. *See id.* at 214.

140. *See id.*

141. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 13. *See generally*, Baker, *supra* note 2, at 55.

142. *See* Marty-Nelson, *Asset Protection Trusts*, *supra* note 37, at 13. For a list of states with statutes that specifically prohibit spendthrift provisions to self-settled trusts, see *id.* at 30 n.95. States without statutes specifically addressing self-settled spendthrift trusts often achieve the same result through judicially-produced common law. *See id.* at 31; 2A SCOTT & FRATCHER, *supra* note 45, § 156, at 165 n.1.

143. Governor Knowles of Alaska signed The Alaska Trust Act into law on April 1, 1997, and shortly thereafter, on July 9, 1997, Governor Carter of Delaware signed amendments to Delaware's trust laws. *See* Douglas J. Blattmachr and Richard W. Hompesch II, *Alaska vs. Delaware: Heavyweight Competition in New Trust Laws*, PROB. & PROP., Jan./Feb. 1998, at 32, 32.

create trusts under this new legislation that will be protected should creditors' claims arise.[144]

A. *The New Laws: What Do They Say?*

The Alaska Trust Act and Delaware's Qualified Disposition in Trust Act amend their codes to allow settlors to make lifetime transfers into trust from which they are eligible, but not entitled, to receive distributions according to the discretion of a third-party trustee.[145] Alaska was the first to enact laws allowing self-settled spendthrift trusts, and Delaware followed just three months later.[146] Most of the essential provisions of the new trust laws are the same, but there are a few significant differences to be noted.[147] The Delaware Act was closely modeled after Alaska's legislation and in fact expressly stated its intention "to maintain Delaware's role as the most favored domestic jurisdiction for the establishment of trusts."[148]

As some other states have recently done,[149] the Alaska Act abolishes the common law rule against perpetuities with respect to Alaskan trusts.[150] This allows a settlor to create a perpetual

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144. *See* Douglas Blattmachr, *Alaska Trusts Offer Unequaled Asset Protection*, PRIVATE ASSET MGMT., Feb. 23, 1998, at 8, *available in* LEXIS, NEWS Library, CURNWS File.

145. *See* ALASKA STAT. § 34.40.110 (Lexis 1998); DEL. CODE ANN. tit. 12, §§ 3570-76 (Supp. 1998); *see also* Blattmachr et al., *supra* note 6, at 347. According to authors of the Act these lifetime transfers are considered complete for federal gift and estate tax purposes. *See* Blattmachr et al., *supra* note 6, at 347. It is possible that the settlor could serve as a trustee who makes or participates in investment decisions with respect to trust assets without exposing those assets to the claims of creditors under Alaska law. *See id.* at 356 n.43. However, if the settlor is a trustee who makes or participates in decisions about whether to make payments to the beneficiaries, of which he is one of, under Alaska law that would expose the trust assets to the claims of his creditors. *See id.*

146. *See supra* note 143.

147. *See* Blattmachr & Hompesch, *supra* note 143, at 34.

148. Qualified Dispositions in Trust Act, Synopsis, Pub. Act 159, 71 Del. Laws 159 (1997), *available in* LEXIS, DEL Library, DEALS File (codified at DEL. CODE ANN. tit. 12, §§ 3570-76 (Supp. 1998)).

149. *See, e.g.*, S.D. CODIFIED LAWS § 43-5-8 (Michie 1997).

150. *See* ALASKA STAT. § 34.27.050(a)(3) (Lexis 1998). Prior to the 1997 amendments, Alaska law already had liberal perpetuities rules. *See id.* § 34.27.050(a)(1)-(a)(2). The amendment totally eliminates perpetuities concerns provided the trust instrument allows that "all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when the trust is created." *Id.* § 34.27.050(a)(3). The amendment adds a third way for nonvested property interest to be valid. The amended law provides: "A nonvested property interest is invalid unless: (1) when the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; (2) the interest either vests or terminates within 90 years after its creation . . . ." *Id.* § 34.27.050(a)(1)-(a)(2). The amendment provides that

trust that will not be considered invalid because it is non-vested, as long as the trustee is granted the discretionary power to distribute all or part of the income or principal to a beneficiary who is living at the time the trust is created.[151] Delaware had previously repealed its perpetuity rules with respect to personal property held in an irrevocable trust.[152] As a result, a qualified disposition of personal property in an irrevocable spendthrift trust will not be subject to any perpetuity rules under Delaware law.[153]

The most noteworthy aspects of the amendments are the new spendthrift provisions. Alaska statute section 34.40.110 and Delaware Code title 12, section 3570(9)(c) permit the creation of self-settled spendthrift trusts that will be enforced against the settlor's creditors providing that the trusts meet certain requirements.[154] The amendments create extremely settlor-friendly rules in varying degrees.[155] While the new laws are similar, there are small differences that affect the amount of creditor protection that they afford.

1. Alaska

Alaska's statute states: "A person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee."[156] Nothing in the statute, nor in any other statute, prohibits the settlor from also being named a beneficiary under the trust instrument.[157] The statute goes on to

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a nonvested property interest is valid if: "(3) the interest is in trust and all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when the trust is created." *Id.* § 34.27.050(a)(3).

151. *See* Douglas J. Blattmachr & Jonathan G. Blattmachr, *A New Direction in Estate Planning: North to Alaska*, TR. & EST., Sept. 1997, at 48, 52

152. *See* DEL. CODE ANN. tit. 25, § 503(a) (Supp. 1998). As for real estate held in an irrevocable trust, Delaware law creates a 110 year "wait and see" period. *See id.* § 503(b).

153. *See id.* § 503(a); *id.* tit. 12, § 3570(9)(c) (Supp. 1998).

154. ALASKA STAT. § 34.40.110 (Lexis 1998); DEL. CODE ANN. tit. 12, § 3570(9)(c) (Supp. 1998).

155. *See* ALASKA STAT. § 34.40.110; DEL. CODE ANN. tit. 12, § 3570-76. The prior Alaska law stated: "A deed of gift, a conveyance or a transfer or assignment, oral or written, of goods and chattels or things in action made in trust for the person making the deed, conveyance, transfer, or assignment is void as against creditors, existing or subsequent, of the person." ALASKA STAT. § 34.40.110 (repealed 1997), *available in* LEXIS, CODES Library, AK1996 File.

156. ALASKA STAT. § 34.40.110(a) (Lexis 1998).

157. *See* Gebbia-Pinetti, *supra* note 11, at 191; *see also* ALASKA STAT. § 34.40.110(b) (specifically allowing the settlor to receive distributions from trust in certain circumstances).

make it clear that neither current nor future creditors may reach a beneficiary's interest in trust.[158] "If a trust contains a transfer restriction allowed under (a) of this section, the transfer restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or another person from satisfying a claim out of the beneficiary's interest in the trust."[159]

However, a beneficiary's interest will not be protected under all circumstances.[160] The Alaska amendments set out four situations in which the assets will not be protected from a beneficiary's creditors.[161] The trust's spendthrift provision will not be enforced if: 1) the transfer was fraudulent according to Alaska law; 2) the trust allows the settlor to revoke or terminate the trust without the consent of an adverse party; 3) the trust requires that all or part of the income or principal, or both, must be distributed to the settlor; or 4) at the time of the transfer into trust, the settlor is in default of making a payment due under a child support judgment by thirty days or more.[162] Conversely, the settlor's creditors will not be able to reach the trust assets if: (1) the settlor is not in default in making a child support payment by thirty days or more; (2) the transfer was not fraudulent as to the settlor's creditors under Alaska law; (3) the settlor does not retain the power to revoke or terminate the trust without the consent of an adverse party; and (4) the settlor is not entitled to mandatory trust distributions but only eligible to receive a distribution upon the discretion of the trustee.[163]

The Alaska Trust Act also includes a jurisdictional claim over trusts created under its Alaska laws by providing that an Alaska choice of law provision will be deemed valid.[164] However, it also imposes rules as to how a trust must be structured in order for it to qualify as Alaskan and benefit from the choice of law provisions.[165] The Act requires: 1) "some or all of the trust assets are deposited in this state and are being administered by a qualified person;" 2) the "trustee is a qualified person who is

158. *See* ALASKA STAT. § 34.40.110(b)(1)-(b)(4).
159. *Id.* § 34.40.110(b).
160. *See id.* § 34.40.110(b)(1)-(b)(4).
161. *See id.*
162. *See id.* The statute defines an adverse party as one "who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust." *See id.* § 34.40.110(b)(2).
163. *See* Blattmachr & Blattmachr, *supra* note 151, at 52; Jonathan G. Blattmachr, *Unique Protection Under Alaska Law: Americans In All States Can Benefit*, N.Y. L. J., Sept. 2, 1997, at 1 [hereinafter Blattmachr, *Unique Protection*].
164. *See generally* ALASKA STAT. § 13.36.035 (Lexis 1998).
165. *See id.* § 13.36.035(c).

designated as a trustee;" 3) the trustee's powers must include maintaining records for the trust and "preparing or arranging for the preparation of . . . an income tax return;" and 4) at least part of the trust administration occurs in state, "including physically maintaining trust records" in state.[166]

The Act also limits the rights of creditors who wish to challenge the trust.[167] If the trust meets all the requirements of Alaska statute section 34.40.110, a creditor may not challenge a transfer into trust or have it voided on the grounds "that the trust or transfer avoids or defeats a right, claim, or interest conferred by law on person by reason of a personal or business relationship with the settlor or by way of a marital or similar right."[168] In addition, the Act limits the time in which a creditor may raise a claim to have a transfer into an Alaska trust set aside. A creditor with a claim that existed at the creation of the trust must bring a claim within four years of the transfer or "one year after the transfer is or reasonably could have been discovered . . . ."[169] One who becomes a creditor subsequent to the transfer only has four years after the transfer is actually made to bring an action, regardless of when it was reasonably discoverable.[170]

In addition to limiting the amount of time creditors have to raise claims, the Act also limits when a transfer will be deemed fraudulent.[171] Alaska's fraudulent transfer statute dictates that

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166. *Id.* § 13.36.035(c)(1)-(c)(4). A "qualified person" includes

> (A) an individual who . . . resides in this state, whose true and permanent home is in this state, who does not have a present intention of moving from this state, ... ;
> (B) a trust company that is organized under AS 06.25 and that has its principal place of business in this state; or
> (C) a bank that is organized under AS 06.05, or a national banking association that is organized under 12 U.S.C. 21-216d, if the bank or national banking association possesses and exercises trust powers and has its principal place of business in this state . . . .

Id. § 13.36.390(1).

167. *See* Blattmachr & Hompesch, *supra* note 143, at 34.

168. ALASKA STAT. § 13.36.310 (Lexis 1998).

169. *Id.* § 34.40.110(d)(1).

170. *See id.* § 34.40.110(d)(2).

171. *See id.* § 34.40.010. The statute provides:

> [A] conveyance or assignment, in writing or otherwise, of an estate or interest in land, or in goods, or things in action, or of rents or profits issuing from them or a charge upon land, goods, or things in action, or upon rents or profits from them, made with intent to hinder, delay, or defraud creditors or other persons of their lawful suits, damages, forfeitures, debts, or demands, or a bond or other evidence of debt given, action commenced, decree or judgment suffered, with the like intent, as against persons so hindered, delayed, or defrauded is void.

a conveyance of property is fraudulent if made "with the intent to hinder, delay, or defraud creditors or other persons of their lawful suits . . . ."[172] The statute does not allow the use of what are referred to as the "badges of fraud" to be considered in proving intent.[173] Thus, it appears to codify the position that constructive fraud will not be grounds for voiding transaction where actual intent is not found. Requiring actual fraudulent intent makes it much harder for creditors to succeed in a fraudulent challenge claim, since a settlor's actual intent is difficult to know and prove. It remains to be seen whether courts will allow transfers to be voided on a theory of constructive fraud.

2. Delaware

Similarly, Delaware's amendments allow the creation of a trust in which "the interest of a beneficiary in the trust property or the income therefrom may not be transferred or assigned, whether voluntarily or involuntarily, before the trustee distributes the property or income to the beneficiary."[174] Delaware enacted a statute of limitations regarding challenges to transfers into trusts similar to the Alaska statute.[175] Delaware law requires a trustee to be either a natural person who is a resident of the state or an institutional trustee that is "authorized by the law of this State to act as a trustee and whose activities are subject to supervision by the Bank Commissioner of the State . . . ."[176] Delaware deviated from Alaska's spendthrift scheme by requiring that the trustee be "neither the transferor nor a related or subordinate party of the transferor."[177] Such a requirement offers added protection to the trust by ensuring that the trustee is truly independent from the settlor.[178]

The Delaware legislation made a few significant changes to the Alaskan scheme, which allow broader recovery than the

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Id.

172. *Id.* If a conveyance is found to be fraudulent the remedy is that the transfer is void as to creditors. *See id.*

173. *See generally id.*

174. DEL. CODE ANN. tit. 12, § 3570(9)(c) (Supp. 1998).

175. *See id.* § 3572(b). *See also* Blattmachr & Hompesch, *supra* note 143, at 35.

176. DEL. CODE ANN. tit. 12, § 3570(8)(a). Although similar to the Alaska provision, this provision is more flexible than Alaska's provision, which requires an individual trustee to be domiciled in Alaska, not merely reside there, and an institutional trustee must maintain its principal place of business in the state. ALASKA STAT. § 34.40.010 (Lexis 1998).

177. DEL. CODE ANN. tit. 12 § 3570(9)(b) (Supp.1998).

178. *See* Blattmachr & Hompesch, *supra* note 143, at 35.

Alaska law.[179] Delaware's fraudulent conveyance laws permit recovery of both intentionally and constructively fraudulent transfers.[180] The statute specifically codifies circumstances in which a transfer will be deemed fraudulent even where actual intent to defraud cannot be proven.[181]

In addition, Delaware law carves out special circumstances in which the spendthrift provision will not apply.[182] It added a provision that creates a class of preferred creditors, which is not found in the Alaska Act.[183] This class includes the settlor's spouse and children, and

> any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which . . . is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable.[184]

This provision is in stark contrast to Alaska's scheme.[185] The Delaware provisions allow children of the settlor as well as current, former, or future spouses to invade a self-settled spendthrift trust in order to satisfy court awarded claims against the settlor.[186] Delaware also allows a party injured by the settlor's acts or omissions, occurring before the settlor made the qualified disposition, to invade the trust.[187] Invasion will be allowed even if the settlor was unaware of the injury and the creditor did not claim that the transfer was fraudulent.[188] Such invasions are not provided for under the Alaska Act. As long as all the trust requirements are met and the transfer of assets into trust was not fraudulent, Alaska law will not recognize any class

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179. *See* DEL CODE ANN. tit. 6 § 1304 (Supp.1996).
180. *See id.*
181. *See id.*
182. *See id.* tit.12, § 3573 (Supp.1998).
183. *See id.*
184. *Id.*
185. *See* Blattmachr & Hompesch, *supra* note 143, at 38.
186. *See id.* at 35. For example, H is unmarried and has no children and no debts. *See id.* at 36. He inherits $3 million and transfers $1 million into a self-settled spendthrift trust naming himself and his brother as beneficiaries. *See id.* Later, H marries W and they have a child. *See id.* Together they make unprofitable investments, and W loses all of her assets that are not in the trust. *See id.* H and W divorce; a court awards W custody of their child, orders H to pay alimony and child support, and $200,000 for division of marital property. *See id.* Under Delaware law, W would be able to invade H's trust in order to satisfy her claim for alimony, child support, and marital property, regardless of whether the initial transfer of assets into the trust was fraudulent. *See id.* Under Alaska law W would not be able to invade a trust so long as it met all the requirements under the Alaska Trust Act. *See id.*
187. *See* DEL. CODE ANN. tit. 12 § 3573 (Supp. 1998).
188. *See* Blattmachr & Hompesch, *supra* note 143, at 38.

of special claimants.[189] However, the Delaware exceptions will not protect subsequent tort victims/creditors who cannot avoid injury by diligence, and subsequent contract creditors whose debts are not induced by reliance on the settlor's claim that the trust assets would be available.[190]

B. *Legislative History: What Purposes Did the Legislatures Have In Mind?*

Prior to the passage of the Alaska Trust Act, Delaware had some of the best trust laws of any state and was one of the leaders in the domestic trust industry.[191] Alaska sought to attract the trust business by enacting more favorable asset protection legislation.[192] Alaska was the first of the two states to pass legislation that specifically allows self-settled spendthrift trusts and limits creditor access to such trusts.[193] Delaware followed just three months later with a very similar statutory scheme.

1. Alaska

It seems clear that the motivation behind the Alaska legislature's passage of the Alaska Trust Act was to stimulate the state's economy.[194] The Act's proponents hoped to encourage financial markets to headquarter in Alaska by establishing Alaska

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189. *See id.* For example, successful surgeon S has a net worth of $5 million has a $5 million malpractice insurance policy and no debts. *See id.* In 1999 S transfers $1 million to a self-settled spendthrift trust naming herself, her spouse, and her children as beneficiaries. *See id.* Subsequently, S experiences financial trouble and loses all her wealth that is not in trust. *See id.* In 2002 a patient S treated in 1998 discovers that S caused him injuries that could not reasonably have been discovered sooner. *See id.* S was unaware that she had caused any injury. *See id.* Patient is awarded a $2 million judgment against S. *See id.* In this case, the patient would be entitled to invade a Delaware trust to satisfy his judgment. *See id.* Conversely, under Alaska law, the patient would not be entitled to invade the trust. *See id.*

190. *See* Gebbia-Pinetti, *supra* note 11, at 231.

191. *See* Blattmachr & Hompesch, *supra* note 143, at 38. South Dakota shared this status with Delaware. *See id.*

192. *See id.* at 32.

193. *See id.*

194. *See Trusts and Property Transfers in Trust: Hearing on HB 101 Before the House Labor and Commerce Standing Comm.* 20th Legis., 1st Sess. (Alaska 1997), *available at* <http://www.legis.state.ak.us> (visited Jan. 29, 1999) [hereinafter *House Trusts Hearings*]; *Trusts and Property Transfers in Trust: Hearing on HB 101 Before the Senate Judiciary Comm.*, 20th Legis., 1st Sess. (Alaska 1997) *available at* <http://www.legis.state.ak.us> (visited Jan. 29, 1999) [hereinafter *Senate Trusts Hearings*].

as an attractive place to administer large trusts.[195] With economic growth as their objective and the trust industry as their means to achieve it, the drafters attempted to write legislation that would effectively compete with the foreign jurisdictions.[196] The drafters' and legislators' intended for the Act to appeal to asset protectors.[197] Outside of attracting state revenue (by catering to the asset protection market), the drafters and legislators did not express other goals.[198] The legislators seemed to understand the necessity that the Act enable asset protection against creditors' claims, yet they did not contemplate the effect of asset protection on creditors other than spouses and children.[199] While these are obviously important concerns, it is noteworthy that the legislators did not debate the legitimacy of asset protection or explore what effect these measures might have on legitimate creditors.[200] Moreover, despite the legislators concern for children and spouses, the Act as passed still allows a settlor to effectively defraud his children or spouse.[201]

The drafters of the Act, as well as the legislators that passed it, were very well aware of the amount of wealth transferred from U.S. settlors into offshore trusts. They saw the positive effects of this wealth on the economies of those jurisdictions and wanted to bring those benefits into Alaska.[202] They were also aware that these foreign jurisdictions experienced such success in the trust industry because they were able to meet the demands of asset

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195. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 085) (statement of Representative Al Vezey).

196. *See generally* Fraser, *supra* note 6, at 1.

197. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 085) (statement of Rep. Al Vezey); *Senate Trusts Hearings*, *supra* note 194 (Tape 97-17, Side A, No. 001) (statement of Rep. Al Vezey).

198. *See generally House Trusts Hearings*, *supra* note 194; *Senate Trusts Hearings*, *supra* note 194.

199. *See generally House Trusts Hearings*, *supra* note 194; *Senate Trusts Hearings*, *supra* note 194.

200. *See generally House Trusts Hearings*, *supra* note 194; *Senate Trusts Hearings*, *supra* note 194. An accountant did testify before the legislators that creditors would not be defrauded by the Act because lenders should inquire into what type of assets a beneficiary has before engaging in a transaction. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side B, No. 909) (statement of Kevin Walsh, CPA). However, this does nothing to protect involuntary creditors. *See* discussion *supra* notes 53-54 accompanying text.

201. *See infra* notes 221-22 and accompanying text.

202. They used the Cook Islands as an example of what could happen in Alaska. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side B, Nos. 001-577) (statements of Rich Hompesch, attorney, Robert Manley, attorney, and Rep. Al Vezey). After the passage of laws that favored asset protection trusts in the Cook Islands, rich and famous people started going there and a market for luxury accommodations sprung up. *See id.* In addition, an attorney testified that he was told at a conference he attended that an estimated $200-$300 billion has been transferred to foreign trusts over the past twenty years. *See id.*

protectors.[203] In order to compete with the foreign jurisdictions, their laws had to meet these demands also.

Representative Vezey, the bill's sponsor, identified a trend in the past one hundred years of U.S. trust law of making trusts weaker by allowing them to be invaded by creditors.[204] He attributed the trend in U.S. law to the frequent invasion of trusts by "so called creditors" who may have become creditors long after the trust's creation.[205] He described how courts use the term "fraudulent transfer" to characterize a conveyance of assets into trust that may have occurred prior to the transaction that resulted in the settlor's debt, to justify invading the trust.[206] His push for legislation opposed to this trend illustrates his belief that such invasion of trusts should be stopped. He stated that as a result of this trend there is a component of the trust market that is looking for strong protection of the trust corpus from invasion by creditors.[207] He asserted that Alaska had the opportunity to allow strong trusts to be created which would be very difficult to invade.[208] He noted that there existed a huge market for trusts that allowed people to preserve large assets and that most of this market went to foreign jurisdictions, which have strong trust laws.[209] Vezey explained that such trusts would bring substantial income to Alaska in the form of administration fees and that the ripple effect to the state's economy would be very desirable.[210] An attorney specializing in estate tax and planning testified that the Act would attract business to Alaska that would primarily benefit attorneys, bankers, certified public accountants, and money managers. However, the attorney also noted that money from this business would permeate the Alaskan economy.[211]

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203. *See generally id.*

204. *See id.* (Tape 97-9, Side A, No. 085) (statement of Rep. Al Vezey).

205. *See id.*

206. *See id.*

207. *See Senate Trusts Hearings, supra* note 194 (Tape 97-17, Side A, No. 001) (statement of Rep. Al Vezey). Rep. Vezey noted that extreme care must be taken to ensure that no fraudulent transfers occur in the creation of these trusts and that there is no intent to defraud future creditors. *See id.* This sounds good, and apparently this persuaded the other legislators, but to a certain extent asset protection is on its face an attempt to defraud future creditors.

208. *See House Trusts Hearings, supra* note 194 (Tape 97-9, Side A, No. 326) (statement of Rep. Al Vezey).

209. *See id.*

210. *See id.* (Tape 97-9, Side A, Nos. 615-1147) (statements of Rep. Al Vezey).

211. *See id.* (Tape 97-9, Side B, Nos. 433-671) (statement of Robert Manley, attorney). In addition, Mr. Hompesch, a Fairbanks attorney, testified that he traveled to the Cook Islands to investigate its trust business and that in its population of 10,000, approximately 150 jobs were attributable to its trust

The legislators were also aware of the policy implications arising from the Act's primary intent to allow the formation of trusts to shield assets from creditors. A prominent trust and estate attorney testified that the bill allowed settlors to create trusts in which their creditors cannot force the invasion of the trust to satisfy a debt so long as the initial conveyance was not fraudulent and the statute of repose had not expired.[212] He compared the bill's provisions to the laws of offshore jurisdictions, which have resulted in billions of dollars to those jurisdictions.[213] Alaska's Assistant Attorney General testified that protection against creditors' claims is the apparent intent of such trusts.[214] The Assistant Attorney General also pointed out the legal fiction that a settlor who is also an income beneficiary is no longer the legal owner of the trust assets.[215]

A similar bill had been introduced the prior year but was vetoed by the Governor's Administration due to concerns that the trusts could be used to avoid child support payments.[216] The previous bill passed both the House and Senate with only one opposition vote in each chamber.[217] Upon questioning about the prior bill's veto, Rep. Vezey replied that it required a vivid imagination to believe that the trusts could be used to avoid child support payments and that the bill had been amended to explicitly address the issue.[218] However, there was doubt expressed as to whether the current version of the bill adequately addressed this issue.[219] Even though the legislators were aware of this potential problem, the bill as still passed room for settlors to avoid child support obligations in some cases. For the trust to avoid invasion, the statute only requires that the settlor is not in default by thirty or more days in child support payments at the time of the transfer.[220] So if the settlor is in default of a child

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industry. *See Senate Trusts Hearings*, *supra* note 194 (Tape 97-17, Side A, No. 001) (statement of Rich Hompesch, attorney). He also predicted that not only will people want to create such Alaskan trusts but that people will want to travel to Alaska thus enhancing its tourism market. *See id.*

212. *See id.* (Tape 97-17, Side A, No. 225) (statement of Robert Manley, attorney). This could leave some legitimate contract or tort creditors of the settlor unsatisfied. Requiring that the initial conveyance not be fraudulent does not protect the effect of leaving such legitimate creditors uncompensated.

213. *See id.*

214. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 1645) (statement of Vincent Usera, Assistant Attorney General).

215. *See id.* (Tape 97-9, Side A, No. 2027) (statement of Vincent Usera).

216. *See id.* (Tape 97-9, Side A, No. 560) (statement of Rep. Al Vezey).

217. *See id.* (Tape 97-9, Side A, No. 326) (statement of Rep. Al Vezey).

218. *See id.* (Tape 97-9, Side A, Nos. 560-615) (statements of Rep. Al Vezey).

219. *See infra* notes 221-22 and accompanying text.

220. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 1347) (statement of Vincent Usera, Assistant Attorney General).

support payment by less than thirty days at the time a transfer is made to the trust and the settlor subsequently stops paying child support, the trust corpus would not be invaded for the child's support. This does not seem like an adequate solution to the risk of people using these trusts to defraud their children.

The Assistant Attorney General actually brought this problem to the legislators' attention. He pointed out that a child could be born after the creation of the trust and could be cut off entirely.[221] In addition, if someone wanted to use the trust as a way to avoid child support payments, he would merely have to be up to date on those payments at the time he created the trust.[222] However, the Assistant Attorney General speculated that anyone who has the assets required to set up this type of trust is not likely to have the intentions of avoiding child support obligations.[223] Nevertheless, he also acknowledged that if the statute is too vague it could be used to avoid such obligations and that "people do this sort of thing all the time."[224]

There seemed to be some confusion regarding the tax effects of these trusts. The Assistant Attorney General stated that the trust would shield the assets from creditors, including the I.R.S.,[225] while an attorney who worked on drafting the bill stated that it was drafted so that money put in the trust would be a completed gift for I.R.S. purposes.[226] If the trust were invadable by creditors (i.e., for child support) then it will not be a completed gift and it would be subject to invasion by anyone.[227] He explained that this was the reason for the thirty day rule on child support obligation.[228] He said the bill was specifically drafted to not allow invasion of the trust once created because by allowing even limited invasion it opened the trust up for attack by any and all creditors.[229] As a result, the statute is worded so that if a settlor is in default by thirty or more days on child support payments at the time of the transfer, the transfer is considered void.[230] This may achieve the benefits of the asset protection but it does not adequately protect children who may be entitled to

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221. *See id.*
222. *See id.*
223. *See id.* (Tape 97-9, Side A, No. 1965) (statement of Vincent Usera, Assistant Attorney General)
224. *See id.*
225. *See id.* (Tape 97-9, Side A, No.1645) (statement of Vincent Usera, Assistant Attorney General).
226. *See id.* (Tape 97-9, Side A, No. 2138) (statement of Dick Thwaites, attorney).
227. *See id.*
228. *See id.*
229. *See id.*
230. *See* ALASKA STAT. § 34.40.110(b)(4) (Lexis 1998).

child support payments from the settlor. The drafters and legislators apparently were convinced that no injustice would occur, because Alaska courts would be deciding such cases so they could make the subsequent changes if necessary.[231]

The bill was clearly intended to completely shield these trusts from any claims of creditors. One attorney testified that the trust may not be invaded for child support obligations because if that were the case the entire trust would be included in the settlor's estate and this would provide little incentive for anyone to set up such a trust.[232] He also justified the child support provisions of the bill by explaining that a deadbeat father would not use these trusts as a way of defrauding children because of the cost of setting up the trust. He claimed that type of people setting up these trusts would not use these instruments as a method of defrauding their families.[233]

The legislators were cautioned against having high expectations of the bill ensuring asset protection and bringing money from offshore jurisdictions into Alaska.[234] It was explained that these offshore jurisdictions have entirely separate sovereignty, whereas Alaska does not.[235] Alaska is subject to the Full Faith and Credit clause of the U.S. Constitution, and it remains to be seen whether people seeking asset protection will find Alaska more appealing than offshore jurisdictions.[236]

Rep. Vezey testified that among the people he surveyed he did not find anyone opposed to the bill.[237] In fact the committee minutes are replete with favorable endorsements of the bill by members of Alaska's professional industry.[238] However, as Rep. Vezey acknowledged, his survey was limited to insurance companies, banks, and various trust officers.[239] Also, the endorsements all came from these groups or other similar professionals such as attorneys and accountants.[240] All the people that testified before the legislature had a lot to gain by the

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231. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 2138) (statement of Dick Thwaites, attorney).

232. *See id.* (Tape 97-9, Side B, No. 070) (statement of Rich Hompesch, attorney).

233. *See id.* (Tape 97-9, Side B, No. 136) (statement of Rich Hompesch).

234. *See Senate Trusts Hearings*, *supra* note 194 (Tape 97-17, Side A, No.276) (statement of Professor Jeffrey Schoenblum).

235. *See id.*

236. *See id.*

237. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 326) (statement of Rep. Al Vezey).

238. *See id. See generally Senate Trusts Hearings*, *supra* note 194.

239. *See House Trusts Hearings*, *supra* note 194 (Tape 97-9, Side A, No. 326) (statement of Rep. Al Vezey).

240. *See id.*

bill's passage. For example, an investment firm manager testified that such firms are generally supportive of the bill because it would create more high-end jobs which would benefit everyone as Alaska becomes more business-friendly.[241] In turn, the manager predicted that if Alaska has a business-friendly image it would encourage people to buy second homes in the state.[242] Financial consultants, CPAs, and attorneys strongly supported the bill for the investment money it would bring, its benefit to Alaska's business community, and the general economic advantages it would bring to Alaska.[243] These advocates of the bill also urged that if Alaska did not take this opportunity another state would take the lead in this area.[244]

An accountant, who testified before the legislature, stated that future creditors of a settlor/beneficiary would not be defrauded. According to this testimony, a lender should investigate the beneficiary's assets before engaging in a transaction.[245] This of course speaks only to creditors that are lenders and ignores many other classes of creditors such as spouses, children, tort victims, etc. He also analogized the use of this type of a trust to other types of transactions that could have a detrimental effect on creditors, such as gifts to charity, transfer of assets to family members, and purchasing insurance policies.[246] However, one very important difference between these transactions and the use of a self-settled spendthrift trust is that this type of a trust would allow the settlor to make the transfer and continue to receive income distributions.[247] This would not be the case with any of the aforementioned alternatives. This CPA also testified that Alaska needed to provide a means of asset protection, recognizing the litigious climate of the country right now, which causes people to worry about providing for future generations.[248] If providing for future generations is really the concern, there are already effective

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241. *See Senate Trusts Hearings, supra* note 194 (Tape 97-17, Side A, No. 329) (statement of Allan Johnston, securities manager).

242. *See id.*

243. *See id.* (Tape 97-17, Side A, No. 381) (statements of Diane Borgeson, financial consultant, Jo Kuchle, E.M. Cox, CPA, & Shelley Ebenal, attorney).

244. *See id.*

245. *See* House Trusts Hearings, *supra* note 194 (Tape 97-9, Side B, No. 909) (statement of Kevin Walsh, CPA).

246. *See id.* Although he followed this by saying he did not think these trusts do work to the detriment of future creditors. *See id.*

247. *See* Blattmachr, *supra* note 144, at 8. *See generally* ALASKA STAT. § 34.40.110 (Lexis 1998).

248. *See House Trusts Hearings, supra* note 194 (Tape 97-9, Side B, No. 1068) (statement of Kevin Walsh, CPA).

means of doing so; this legislation tries not only to provide for the future but to allow for the current enjoyment as well.

The Alaska legislators were particularly interested in how exactly these amendments would bring revenue into the state. They expressed concern that the statute's requirement that "some or all of the trust assets be deposited" in Alaska would not ensure that a significant amount of the assets will be deposited in state.[249] They suggested requiring a particular percentage of the assets be deposited in Alaska.[250] However, an attorney who worked on the bill testified that the revenue would come to Alaska through the administration fees which would be based on the total value of the trust, not just what is located in the state.[251] In addition, any legal issues resulting from such a trust would require consultation with an Alaskan attorney, and any litigation that the trusts generated in the Alaska courts would be economically beneficial to the Alaska judicial system.[252]

The representatives also voiced some concern over the possibility of a grantor being able to do what some may think is "immoral," such as disinheriting a spouse or other family members.[253] They were placated by testimony that under Alaska law it is prohibited to completely disinherit a spouse and that spouses are entitled to an elective share of the decedent spouse's augmented estate.[254] The bill was specifically amended to make these trusts part of the augmented estate.[255] While this protects one who is the settlor's spouse at the time of settlor's death, this does nothing to protect former spouses to whom alimony is owed or children of the settlor who may be entitled to child support.[256]

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249. *See id.* (Tape 97-9, Side B, Nos. 1296-1425) (statements of Dick Thwaites, attorney). The representatives were worried that a settlor could arrange for only one dollar to be deposited in Alaska and that little revenue would be brought into the state if that was allowable. *See id.*

250. *See id.*

251. *See id.* (Tape 97-9, Side B, No. 1425) (statement of Rep. Al Vezey).

252. *See id.* (Tape 97-9, Side B, No.1296) (statement of Chairman Rokeberg). It should be noted that the Executive Committee of the Probate and Planning Section of the Alaska Bar did not take a position on the bill because they would have to go to the Board of Governors of the Bar Association. *See id.* (Tape 97-9, Side B, No.1750) (statement of Chairman Rokeberg). Apparently this process was time-consuming and wouldn't occur before the legislative session was over. The Assistant Attorney General pointed out that his office should not be perceived as attacking the bill. *See id.* He said there are no estate or taxation attorneys in the Department of Law and that there is no need for any attorneys. *See id.* In addition, there is no state agency that has any oversight responsibility for this bill; his office was merely asked to review and report on it. *See id.*

253. *See id.* (Tape 97-9, Side B, No.2108) (statement of Chairman Rokeberg).

254. *See id.* (statement of Robert Manley, attorney).

255. *See id.*

256. *See generally* ALASKA STAT. § 34.40.110 (Lexis 1998) (lacking any protection for former spouses and only protecting children by requiring the settlor

2. Delaware

Just three months later, Delaware enacted legislation similar to the Alaska statute with small, but not insignificant differences.[257] Delaware's reaction of modeling its Qualified Dispositions in Trust Act after the Alaska legislation may be seen as legitimizing the use of domestic trusts to protect assets from creditors.[258] However, the Delaware legislation contains exceptions for certain classes of claimants and reflects an attempt to adhere to what has been the traditional public policy in the United States. Such adherence, in the face of Alaska's attempt to move away from fundamental U.S. notions of public policy, makes the Alaska legislature's disregard for fairness even clearer.

The drafters of Delaware's legislation expressly stated their intent to maintain Delaware's status as "the most favored domestic jurisdiction for the establishment of trusts."[259] The legislators also stated that the purpose of the Act was to allow trust settlors to transfer assets from their estates in order to reduce the federal estate taxes that otherwise would be due upon their death.[260] They realized that in order to accomplish this a settlor could not retain any enforceable rights to the income or principal of the trust but that the settlor could receive discretionary distributions as a beneficiary.[261] They also realized that the trusts could not be subject to the settlor's creditors' claims in order to have the trust assets excluded from the settlor's estate for tax purposes.[262] This declaration of the

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not be in default of child support payments by more than thirty days); *id.* § 13.36.310 (stating that other than as specified in § 34.40.110 trusts cannot be voided on the basis that their existence avoids a marital obligation of the settlor).

257. *See* Blattmachr & Hompesch, *supra* note 143, at 32. Governor Knowles approved The Alaska Trust Act on April 1, 1997. *See* Alaska Trust Act ch. 6, 1997 Alaska. Sess. Laws 6, *available in* LEXIS, ALAS Library, AKALS File (codified at ALASKA STAT. §§ 13.12.205(2), 13.36.035(a), 13.36.035(c)-(d), 13.36.045(a), 13.36.310, 13.36.390. 34.27.050(a), 34.40.010, 34.40.110). Governor Carter approved the Qualified Dispositions in Trust amendments to Delaware law on July 9, 1997. *See* Qualified Dispositions in Trust Act, Pub. Act 159, 71 Del. Laws 159 (1997), *available in* LEXIS, DEL Library, DEALS File (codified at DEL. CODE ANN. tit. 12, §§ 3570-76).

258. *See* Blattmachr & Hompesch, *supra* note 143, at 38.

259. Qualified Dispositions in Trust Act, Synopsis, Pub. Act 159, 71 Del. Laws 159 (1997), *available in* LEXIS, DEL Library, DEALS File

260. *See id.*

261. *See id.*

262. *See id.* However, they went on to list three situations in which creditors may reach the trust assets. *See id.* The synopsis states that the Act renders the trusts subject to:

> (1) obligations to children, spouses and former spouses under a domestic agreement or court order, (2) obligations to any creditor who was induced

legislators' purposes in enacting the Act and their intentions as to what they sought to accomplish underscores that providing effective asset protection through the enforcement of self-settled spendthrift trusts was the bottom line goal. In order to compete with Alaska for trust business, which seeks to compete with offshore jurisdictions, Delaware had to enact legislation similarly beneficial to asset protection.

IV. WILL THE ALASKA AND DELAWARE STATUTES ACHIEVE THEIR DESIRED GOALS?

There has been a good deal of speculation as to whether a creditor will be able to successfully invade an Alaska or Delaware self-settled spendthrift trust. Supporters of the new legislation expound the asset protection guarantees of the new laws.[263] While they quietly recognize what they deem to be the small potential for creditors to gain access to assets placed in the new trusts, they tend to gloss over this risk without thorough analysis.[264] It is not surprising that the most ardent and vociferous supporters of these new laws are the same individuals responsible for their passage. Other experts in the field of estate planning and asset protection have been a bit more skeptical about the effectiveness of the new trusts.[265] While supporters

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by a settlor to extend credit on the strength of the settlor's financial statement or other written representation that the trust assets were available to satisfy the debt; and (3) claims arising out of fraudulent transfers if such claims are brought within the time limits provided for in this Act.

Id.

263. *See generally* Blattmachr & Blattmachr, *supra* note 151, at 48; Blattmachr, *Unique Protection*, *supra* note 163, at 7; Blattmachr, *supra* note 144, at 8.

264. *See generally* Blattmachr & Blattmachr, *supra* note 151, at 48; Blattmachr, *Unique Protection*, *supra* note 163, at 7; Blattmachr, *supra* note 144, at 8.

265. *See* A. Barry Nelson & Rosario Ferrero Carr, *Drafting to Achieve Maximum Flexibility in the Estate Plan*, 25 EST. PLAN. 252, 255 (1998) (cautioning potential clients that there is no guarantee that the purported asset protection benefits of the Alaska and Delaware trust will actually be obtainable, and recommending a conservative approach regarding these trusts until the waters have been tested); Alson R. Martin, *Recent Developments in Tax, Employee Benefits, and Business Law*, *in* SC58 PROFESSIONAL ORGANIZATIONS, QUALIFIED PLANS, HEALTH CARE, AND WELFARE BENEFITS 1, 118 (A.L.I.-A.B.A. Course of Study 1998) (stating that Alaska law may not apply to a settlor who lives and does business outside Alaska, thus making the trusts more vulnerable to creditors' claims); McMenamin, *supra* note 6, at 94 (explaining that if a settlor lives in a state other than Alaska, a creditor or tort claimant could try to sue in the settlor's state of residence and the court would likely apply that state's law).

are claiming that the new trusts will replace the need for asset protectors to look to offshore trusts, critics claim that offshore trusts still offer the best in creditor protection.[266]

A. *United States Fraudulent Conveyance Law—A Threat to the Success of Alaska and Delaware Self-Settled Spendthrift Trusts*

Under some states' laws a transfer will be considered fraudulent, and therefore void as to creditors, if it results in harming the creditors, even without the transferor having actual intent to defraud.[267] Under these laws, "constructively fraudulent" transfers will be found void against a transferor's creditors.[268] A creditor could sue the settlor of an Alaskan trust in one of these states and have the settlor's transfer of assets into trust voided if the settlor is harmed by the conveyance, regardless of the settlor's actual intent. An Alaska court would have to enforce such a judgment because of the Full Faith and Credit clause of the Constitution.[269]

Fraudulent conveyance law is an extremely important factor to be considered in asset protection.[270] Its general purpose is to prevent a debtor from transferring assets out of the reach of his creditors with the intent or effect of leaving the debtor without assets to pay legitimate debts.[271] If a transfer made as part of an asset protection plan is found to be a fraudulent conveyance, the transferor's creditors may be able to reach the transferred property.[272] A transfer of assets into trust may be vulnerable to creditor's attacks even if the settlor has only legitimate motives for the transfer such as estate planning or tax purposes.[273]

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266. For support for the new legislation see, for example, *supra* note 263. For criticism of the new legislation see, for example, *supra* note 265.

267. *See* UNIF. FRAUDULENT CONVEYANCE ACT §§ 4-6, 7A U.L.A. 67,105, 110 (1999) (superseded by the UNIF. FRAUDULENT TRANSFER ACT, passed in 1984, 7A U.L.A. 266).

268. *See id.* § 4, 7A U.L.A. 67. Only five states and one U.S. territory have such laws. *See id.*, 7A U.L.A. 2.

269. *See* U.S. CONST. art. IV, § 1. The Full Faith and Credit clause is considered to be a part of each state's conflict of laws rules. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 cmt. b (1971).

270. *See* LEWIS D. SOLOMON & LEWIS J. SARET, ASSET PROTECTION STRATEGIES, TAX AND LEGAL ASPECTS, 5-6 (1993). A fraudulent conveyance is a transfer made, or presumed to be made, with the intent to delay or defraud creditors. *See id.* at 6. A conveyance made with a lack of fair and valuable consideration may also be characterized as fraudulent. *See id.*

271. *See* Gebbia-Pinetti, *supra* note 11, at 215.

272. *See* SOLOMON & SARET, *supra* note 270, at 6. This result would undermine an individual's asset protection plan. *See id.*

273. *See* Gebbia-Pinetti, *supra* note 11, at 215.

Although Alaska's and Delaware's laws purport to ensure their respective laws will be applied in determining whether a fraudulent conveyance occurred, conflict of laws rules may allow a creditor to sue a debtor in another state and have that state's law apply.[274] This is a potential threat to the amount of asset protection that the new trusts can offer because a creditor could sue a settlor in a state in which it is easier to prove that a fraudulent conveyance occurred.[275] If a transfer into an Alaska or Delaware trust is determined by a court to be fraudulent and therefore void, the creditor may be allowed to collect the amount of the debt from trust assets.

States generally have adopted one of three models of fraudulent transfer statutes: the Statute of Elizabeth, the Uniform Fraudulent Conveyance Act (UFCA), or the Uniform Fraudulent Transfer Act (UFTA).[276] The models provide different standards for what constitutes a fraudulent conveyance and may yield different results depending upon which one is applied. All three models condemn transfers made with actual intent to defraud creditors; however, a transfer may also be voided if it was constructively, but not actually, fraudulent.[277]

The Statute of Elizabeth prohibits debtors from making conveyances with "intent to delay, hinder or defraud creditors or others."[278] This model requires the creditor to prove actual intent to defraud, and constructively fraudulent transfers are not voidable.

The UFCA expands the definition of a fraudulent conveyance to include constructive fraud by reference to the objective effects of a disposition upon the financial situation of the debtor and his creditors.[279] As a result, transfers having the objective consequence of harming the debtor's creditors may be found fraudulent, without regard for the transferor's subjective intent.[280] The UFCA makes clear that it applies to present and to future creditors.[281] Thus, a transfer may be voided if it was made

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274. *See id.*

275. *See* McMenamin, *supra* note 6, at 94.

276. *See* Gebbia-Pinetti, *supra* note 11, at 217. Nine states rely on statutes mirroring the Statute of Elizabeth, five states have adopted the UFCA, and thirty-six have adopted the UFTA. *See id.*

277. *See id.* at 218.

278. Gebbia-Pinetti, *supra note* 11, at 219 (quoting Statute of Elizabeth, 13 Eliz. 1 ch. 5, § 1 (1571) (Eng.).

279. *See* ALCES, *supra* note 59, ¶ 5.01[2][b].

280. *See* Gebbia-Pinetti, *supra* note 11, at 217.

281. *See* UNIF. FRAUDULENT CONVEYANCE ACT § 7, 7A U.L.A. 113 (1999). The code states "[e]very conveyance made . . . with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." *Id.*

with the purpose of hindering, delaying, or defrauding someone in the future, even if the settlor had no debt at the time of the transfer.[282] The UFCA allows constructively fraudulent transfers to be set aside where a conveyance is made without fair consideration and leaves the transferor insolvent as to present creditors.[283] The UFCA also provides that a conveyance is fraudulent to both current and future creditors if made without fair consideration by one who either "intends or believes that he will incur debts beyond his ability to pay."[284] These provisions pose potential problems for asset protectors, because a transfer made with the intent to protect assets against present or future, known or unknown, creditors could fall within the language of voidable transfers under the UFCA.[285]

The UFTA, like the UFCA, applies to either existing or future creditors.[286] The UFTA also includes a non-exclusive list of factors that may be used as objective evidence to prove the debtor's actual intent.[287] Thus, a settlor's transfer of assets into

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282. *See* Gebbia-Pinetti, *supra* note 11, at 220.

283. UNIF. FRAUDULENT CONVEYANCE ACT § 4, 7A U.L.A. 67. In addition, UFCA provides that a transfer made without fair consideration by one who is engaged or about to engage in a transaction for which he will have small remaining capital is fraudulent with respect to present and future creditors. *See id.* § 5, 7A U.L.A. 105. This could apply to a settlor who transfers assets into trust and then engages in a risky profession, such as heart surgery, without adequate insurance. *See id.* § 6, 7A U.L.A. 110.

284. *Id.* § 6, 7A U.L.A. 110. This could apply to a settlor who transfers assets into trust with the expectation that he will incur debts for which he will have inadequate assets to cover. *See* Gebbia-Pinetti, *supra* note 11, at 232.

285. *See* Gebbia-Pinetti, *supra* note 11, at 222; UNIF. FRAUDULENT CONVEYANCE ACT, § 7, 7A U.L.A. 113.

286. UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1), 7A U.L.A. 301. The statute provides that: "A transfer made . . . by a debtor is fraudulent as to a creditor, whether that creditor's claim arose before or after the transfer was made . . . , if the debtor made the transfer . . . : (1) with actual intent to hinder, delay, or defraud any creditor of the debtor . . . ." *Id.*

287. *Id.* § 4(b), 7A U.L.A. 302.

> In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:
> (1) the transfer or obligation was to an insider;
> (2) the debtor retained possession or control of the property transferred after the transfer;
> (3) the transfer or obligation was disclosed or concealed;
> (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
> (5) the transfer was of substantially all of the debtor's assets;
> (6) the debtor absconded;
> (7) the debtor removed or concealed assets;
> (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

trust may be constructively fraudulent and therefore voidable if some of these factors are present, even if the settlor did not have, or it cannot be proved he had, actual intent.[288] Under these factors, a transfer in which the debtor retains too great a degree of possession or control may be suspect.[289] A settlor who retains a beneficial interest in a self-settled trust may be caught in this category.

B. *United States Conflict of Law Rules: A Way to Crack an Alaska or Delaware Self-Settled Spendthrift Trust*

Under conflict of laws rules, if a settlor is domiciled outside of Alaska or Delaware, a creditor may be able to sue the settlor in the settlor's state of domicile and persuade the court to apply the fraudulent conveyance law of that state.[290] If the creditor prevailed and a court held that the settlor's transfer of assets into trust was fraudulent, Alaska and Delaware would most likely have to recognize and enforce such a judgment.[291]

Since the Alaska and Delaware laws narrow the scope of fraudulent conveyance law as applied to their trusts, it is to the advantage of a creditor to sue in another state and request that the court apply the law of that state to determine whether the transfer of the assets into trust is voidable.[292] The Alaska Trust Act repealed Alaska's version of the Statute of Elizabeth, which made transfers to trust for the benefit of the settlor void as to the settlor's creditors, regardless of whether the creditors' claims arose before or after the trust's creation.[293] The new law provides that a trust for the benefit of a settlor including a spendthrift provision prevents a creditor existing at the creation of the trust, a subsequent creditor, or any other person, from satisfying a claim with the settlor's interest in the trust.[294] The law provides

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(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
(11) the debtor transferred the essential assets of a business to a lienor who transferred the assets to an insider of the debtor.

Id. These factors are commonly referred to as the "badges of fraud." *See* Turner & Henkel, *supra* note 14, at 4.

288. *See* Gebbia-Pinetti, *supra* note 11, at 215.

289. *See* UNIF. FRAUDULENT TRANSFER ACT § 4(b)(2), 7A U.L.A. 302 (1999).

290. *See* Gebbia-Pinetti, *supra* note 11, at 215.

291. *See id.* at 253. This is due to the Full Faith and Credit clause of the U.S. Constitution. *See* U.S. CONST. art. IV, § 1.

292. *See* Gebbia-Pinetti, *supra* note 11, at 218.

293. *See* Blattmachr & Hompesch, *supra* note 143, at 34.

294. See ALASKA STAT. § 34.40.110(a)-(b) (Lexis 1998).

that the spendthrift provisions will be enforced so long as the trust meets certain requirements including that the initial transfer was not fraudulent under Alaska law.[295]

Alaska's and Delaware's laws try to prevent creditors from suing in other states and from having other states' fraudulent transfer laws determine whether a transfer of assets into trust will be set aside.[296] The new Alaska laws: 1) allow a settlor to choose Alaska law to govern the trust, and provide that the settlor's choice of law will be enforced as long as the trust meets certain conditions; 2) grant Alaska courts exclusive jurisdiction over trusts that contain valid choice of law provisions; and 3) require that Alaska law be applied to determine the validity of Alaska choice of law clauses.[297] Likewise, Delaware law allows the trust instrument to include a Delaware choice of law clause if the trust meets the requirements of a qualified disposition and permits, but does not require, the settlor to receive distributions.[298]

Whether the benefits of this legislation will be enforced depends upon whether the settlor's choice of law claim will withstand a creditor's challenges. A creditor will likely commence an action challenging the transfer of assets into an Alaska or Delaware trust in another state in order to avoid Alaska's and Delaware's rather settlor-friendly laws. The state in which the creditor brings suit will have to apply its own choice of law rules to decide whether to apply Alaska or Delaware law, its own law, or the law of another state to determine the fraudulent transfer issue. The court will have to decide whether the settlor's choice of law applies to the fraudulent transfer action and, if so, whether the court can override that choice.[299] It may seem as if this issue should be analyzed from the perspectives of conflict of laws rules

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295. *See id.* § 34.40.110(b)(1).

296. *See* Gebbia-Pinetti, *supra* note 11, at 237.

297. *See* ALASKA STAT. § 13.36.035(a), (c)-(d). For the Alaska choice of law provision to be valid the following four conditions must be met:

> (1) some or all of the trust assets are deposited in this state and are being administered by a qualified person; . . .,
> (2) a trustee is a qualified person who is designated as a trustee under the governing instrument or by a court having jurisdiction over the trust;
> (3) the powers of the trustee . . . include . . .
> (A) maintaining records for the trust . . . ., and
> (B) preparing . . . income tax return that must be filed by the trust; and
> (4) part or all of the administration occurs in this state . . . ."

Id. § 13.36.035(c).

298. DEL. CODE ANN. tit. 12 §§ 3570(9)(a), 3571 (Supp. 1998).

299. *See* Gebbia-Pinetti, *supra* note 11, at 244.

with respect to either contracts or trusts.[300] However, an action by a creditor to avoid a transfer of property into trust is neither a contract issue nor one between the parties of a trust. The fraudulent transfer cause of action could be characterized as a quasi-tort claim in which the creditor seeks an equitable remedy.[301] The creditor is asking the court to apply the law of a state other than Alaska or Delaware because those states have little relationship to the fraudulent transfer action.[302] The scope of the settlor's choice of law is limited to issues relating to the internal affairs of the trust and to those who are party to the trust.[303] Neither the party to a contract nor the settlor of a trust may bind third parties to their choice of law.[304] For this reason, the state may reject the attempt to bind creditors to the debtor's choice of law.[305] Once the Alaska and Delaware choice of law has been rejected, the court will likely apply the law of the state that has the most significant relation to the issue being litigated.[306]

Assuming a creditor can convince a court to apply state law other than Alaska and Delaware and the creditor wins his fraudulent conveyance cause of action, the next question is whether Alaska and Delaware will honor such a judgment. Under the U.S. Constitution, "[f]ull faith and credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."[307] So, assuming the judgment is valid, it must be given effect in Alaska and Delaware unless an exception applies. The Restatement provides defenses that might allow a state to refuse to enforce the judgment of another.[308] A state may refuse to enforce another state's judgment if the judgment improperly interferes with important interests of the state.[309]

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300. *See id.* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 186-88 discusses conflict of laws rules as applied to contracts and §§ 267-82 discusses conflict of laws rules as applied to trusts. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 186-88, 267-82 (1971).

301. *See* Gebbia-Pinetti, *supra* note 11, at 247.

302. *See id.* The situation is similar to one in which an Illinois debtor gives assets outright to a friend in Alaska, who both agree that Alaska law will govern the gift. *See id.* An Illinois creditor sues the debtor in Illinois for making a fraudulent conveyance, because the gift left the debtor insolvent and unable to pay his debt, and asks the court to apply Illinois fraudulent conveyance law. *See id.* It is doubtful that a court would force the transferor and transferee's attempt to bind creditors to Alaska fraudulent transfer law. *See id.*

303. *See id.*

304. *See id.*

305. *See generally* Marine Midland Bank v. Portnoy (*In re* Portnoy), 201 Bankr. 685 (Bankr. S.D.N.Y. 1996); Ferrari v. Barclays Business Credit, Inc. (*In re* Morse Tool, Inc.),108 Bankr. 384 (Bankr. D. Mass. 1989).

306. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2) (1971).

307. U.S. CONST. art. IV, § 1.

308. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 103-21.

309. *See id.* § 103. The RESTATEMENT notes that:

However, a state must enforce a judgment, even if the original claim is contrary to a strong public policy of the state in which enforcement is sought.[310] Read together, these rules suggest that a state must enforce another state's judgment even if the original claim violates strong public policy of the enforcing state, unless enforcement would involve an improper interference with the enforcing state's interests.[311] The Restatement adds that "[a]lmost invariably, the federal policy of full faith and credit will outweigh any interest that a state may have in not recognizing or enforcing a sister State judgment . . . . "[312] The only strong state interest Alaska or Delaware could possibly assert is its desire to bring trust business into the state or to protect trusts that are already established under its laws. Based on the legislative history previously discussed, there is nothing else in the record that was asserted as a reason for passing the bill.[313] It is doubtful that these interests would permit a state to refuse to enforce another state's judgment.[314] If the trustee refused to comply with the judgment, he would likely be subject to an order of contempt.[315]

C. *What to Do? Change the Laws, or Change U.S. Policy?*

The Alaska legislature could choose to make its laws consistent with those of Delaware and with U.S. policy by enacting an amendment to make an exception for tort victims. The Restatement lists four specific classes of creditors which present such compelling public policy claims that they should be able to reach a spendthrift trust.[316] Although tort victims are not on the enumerated list, the Restatement notes that a spendthrift trust should also be accessible by the creditor of a beneficiary when "considerations of public policy so require. Thus it is

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> [t]he rule of this Section has an extremely narrow scope of application. Full faith and credit requires, almost invariably, that a valid State judgment be recognized in sister States, which means that the judgment must be given the same conclusive effect with respect to the parties, the subject matter of the action and the issues involved that the judgment would have in the State of rendition . . . .

Id. § 103 cmt. a.

310. *See id.* § 117.

311. *See* Gebbia-Pinetti, *supra* note 11, at 254.

312. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 103 cmt. b.

313. *See generally House Trusts Hearings*, *supra* note 194; *Senate Trusts Hearings*, *supra* note 194.

314. *See* Gebbia-Pinetti, *supra* note 11, at 255.

315. *See id.* at 256.

316. RESTATEMENT (SECOND) OF TRUSTS § 157 (1959).

possible that person who has a claim in tort against the beneficiary of a spendthrift trust may be able to reach his interest under trust."[317] While few cases have addressed the issue of whether a tort victim should be entitled to invade a trust, those that have tend to reject making an exception.[318] However, Georgia and Louisiana have passed statutes creating an exception for tort creditors.[319]

Some have suggested compromise that provides creditors with a way of obtaining satisfaction on their claims yet also protects the essence of the spendthrift provision by insulating a significant portion of the beneficiary's trust interest.[320] One author's proposal for reform stated that she "would retain the venerable rule that a settlor cannot create a valid spendthrift provision for her own benefit."[321]

V. CONCLUSION

The broad purpose behind these legislative amendments is each state's desire to bolster its economy and bring revenue into the state. These states decided, as a way to achieve this goal, to attempt to lure the offshore trust market into their states. They saw the vast amounts of money and jobs situated in the offshore jurisdictions with favorable asset protection legislation. In order to compete with these foreign markets and entice this business into their states, they sought to mimic the legislation that has allowed the asset protection industry to flourish in these offshore havens.

The result of this desire is essentially a marketing strategy that advertises favorable law to attract wealthy asset protectors. The problem with this means of raising state revenue is that well-settled concepts of fairness in creditors' rights issues are being sacrificed. This has the potential to cause offensive outcomes where spouses and children of settlors are denied support payments, and injured victims who have won tort judgments against settlors are denied compensation. These are results that have caused criticism of the use of offshore trusts, and yet they are precisely the same results that will occur if the Alaska and Delaware legislation accomplishes its intended purpose.

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317. *Id.* § 157 cmt. a.
318. *See* Brooks, *supra* note 76, at 110.
319. *See* GA. CODE ANN. § 53-12-28(c)(1) (1997), LA. REV. STAT. ANN. § 9:2005 (West 1991).
320. *See* Brooks, *supra* note 76, at 142-43.
321. Emanuel, *supra* note 61, at 208.

Since the Alaska and Delaware laws as amended are not very favorable to creditors, many settlors seeking to protect their assets will likely create trusts in these states.[322] This is in fact what the lawmakers are hoping will occur. They hope that earning the reputation as being "asset protection friendly" will act as an incentive for individuals to create their trusts in these two states. However, this could result in courts from other states viewing transfers made to trusts in these states as suspiciously fraudulent, even if the settlor has legitimate estate planning goals.[323]

Some authors and experts in the field have concluded that the new trust provisions coupled with the fraudulent transfer law amendments serve no other purpose than asset protection.[324]

The offshore trust offers the unique combination of asset protection without having to place the money completely out of the settlor's control. It is this unique benefit of offshore trusts that the Alaska and Delaware lawmakers sought to copy.[325] This recent legislation could potentially yield the same unfair result as in the hypothetical mentioned in the introduction. However, whether the recent legislation will accomplish this unique combination of benefits to settlors and the potential detriment to creditors has yet to be tested by a court.[326] Therefore, it remains to be seen whether the traditional U.S. concepts of fairness will prevail, or whether the Alaska and Delaware trusts will be upheld.

Amy Lynn Wagenfeld[*]

322. *See* Gebbia-Pinetti, *supra* note 11, at 211.

323. *See id.* at 215.

324. *See id.* at 260.

325. *See* Fraser, *supra* note 6, at 1. Alaska State Representative Al Vezey, R-North Pole, who sponsored the Alaska legislation said, "We had research that showed large sums of money going over to the Cayman Islands, and asked, 'Why couldn't we do that?' The answer came back: 'We could.'" *Id.*

326. As of the writing of this Note no court has been faced with deciding the validity of an Alaska or Delaware trust or the enforceability of such a trust against a settlor's creditors.

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TOPIC IV

The Role of Offshore Jurisdictions in the Development of the International Trust

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