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Worshiping At the Feet of Wealth: Self-Settled Asset Protection Trusts and Their Public Policy Implications

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WORSHIPING AT THE FEET OF WEALTH: SELF-SETTLED ASSET PROTECTION TRUSTS AND THEIR PUBLIC POLICY IMPLICATIONS

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"In refusing to set aside the voluntary transfer of a remainder interest in 1916, Judge Learned Hand had this to say: We have no public concern for the preservation of family inheritances, and ought, I believe, have no tenderness towards expectants of rich reversions... I find it hard to have patience with the waterish sentiment which seeks to make such a man the court's ward, and to protect him against the consequences of his own folly. If he is to have the enjoyment of great wealth, let him share its responsibility. If the prospect of a dollar so teased his appetite that the future ceased to be a reality, either let him be regarded as an incompetent and put in ward, or let us treat him as a person in a world of persons, and let him weave his fate as he will."[1]

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[1] Adam J. Hirsch, *Spendthrift Assets and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L. Q. 1, 74 (1995).

INTRODUCTION

In the last decade or so, American trust law has shifted from some of its original moorings to accommodate greater business and wealth interests through a financial device called "Domestic Self-Settled Asset Protection Trusts" (DAPTs).[2] That is, the history of trust law in the U.S. has disallowed utilization of a trust to protect one's assets for one's own personal benefit as the settlor and beneficiary.[3] This more recent change stems from a desire to further protect an individual's assets from creditors, perhaps in part due to the fears about the legal liability system in the United States.[4] This change is thought to mitigate some of the effects of the liability litigation issues in the U.S. and create a more efficient credit marketplace (among other benefits), but comes with significant costs that have been failed to be recognized by legislatures. Among them is that this protective structure allows the wealthy to escape liability both of their own volition from voluntary creditors and from involuntary creditors. Involuntary creditors do not choose their debtors, such as a child in need of child support. More simply, DAPTs disadvantage both creditors that choose to lend money, such as consumer debt lenders, and those like tort victims, that have no control over who owes them funds. The primary concern of this note is summarizing the public policy concerns debated by scholars in a concise way and critiquing them. Secondly, this note seeks to compile various alternative structures suggested by scholars. Part I will explain the basic nature of spendthrift trusts and explain the history leading to the current DAPT structure. Part II will briefly explore the differences between Offshore Self-Settled Asset Protection Trusts (OAPTs) and DAPTs. Part III provides an overview of the relevant policy arguments for and against DAPT statutes and an analysis of their relative persuasiveness. Part IV suggests potential solutions to mitigate potential harms from the current DAPT structure. Finally, Part V concludes the paper with a summary.

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[2] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 HASTINGS L. J. 287, 318 (2002).

[3] *See id.*

[4] *See* Amy Lynn Wagenfeld, *Law for Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth that Follows*, 32 VAND. J. TRANSNAT'L L. 831, 836 (May 1999); Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability?*, 35 REAL PROP. PROB. & TR. J. 479, 526 (2000).

A. Brief History of Spendthrift Trusts

A trust has been described as "the designation of specific property to be held by one party for the benefit of another party."[5] This asset protection scheme can be used to accomplish numerous goals including extending dead hand control over funds left to children, setting up trusts to provide specific care in the instance of disability or need, and separating marital assets, among other purposes. A brief overview of the trust set up is helpful here. A trust settlor is one who submits their assets to the trusts to be managed by a trustee (who holds the legal interests in the trust property) for the benefit of a beneficiary. A DAPT conversely lists the settlor as the beneficiary but retains the spendthrift nature, meaning the settlor retains the fruits of their assets without the risks of creditor claims.[6] Figure 1, below, simplifies this explanation.

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[5] Alexander B. Shiffman, *The Domestic Asset Protection Trust and Its Federalism Implication*, 13 CARDOZO PUB. L. POL'Y & ETHICS J. 853, 858 (2015).

[6] Danforth, *supra* note 2, at 290.

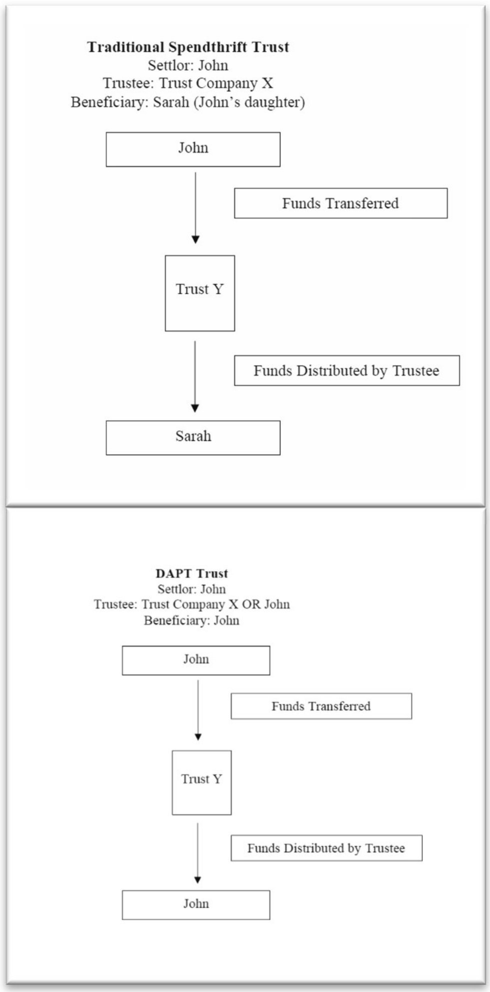

Figure 1

The spendthrift provision of trusts is most relevant to the issue at hand. Spendthrift provisions, in short, can restrict "voluntary or involuntary alienation of the beneficiary's interest in the trust."[7] That is to say, the beneficiary cannot sell or transfer their interest. Additionally, the spendthrift provision can prevent an involuntary transfer of the interest, such as an order from a bankruptcy proceeding.[8] Most trusts, by choice or

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[7] Susanna C. Brennan, *Changes in Climate: The Movement of Asset Protection Trusts from International to Domestic Shores and Its Effect on Creditors' Rights*, 79 OR. L. REV. 755, 761–62 (2000).

[8] Lischer, *supra* note 4, at 491.

by law, include both restrictions.[9] More simply, the beneficiary benefits from the distribution of funds but can neither sell their interest nor can creditors reach the funds.

The very nature of spendthrift provisions, regardless of the beneficiary's identity, have been debated. First, one scholar argues that these provisions should be disallowed because they are "antithetical to the liberal economic model of a free-market economy" by having alienation restraints.[10] Second, spendthrift provisions mislead creditors to overestimate a beneficiary's assets.[11] Third, protection from creditor repercussions could create "socially undesirable behavior" on the part of the beneficiary.[12] That is, beneficiaries have little to lose in "tak[ing] excessive credit risks."[13] Scholars have structured this argument as "aggravat[ing] moral hazard" by creating an incentive structure of risk.[14] Finally, this is argued to create unnecessary complexity in the lender decision-making process.[15] Another scholar attributes the debate to the idea of separating assets from their debtors. This enables anyone to escape a debtor by removing their assets from the creditor's reach through a trust to benefit someone else.[16]

The moral, social, and psychological pros, and cons to such a structure pose very real policy problems. Many of these critiques also are made of DAPTs.

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[9] *See id*.

[10] *Id*.

[11] *See id.*

[12] *Id.*

[13] Hirsch, *supra* note 1, at 66.

[14] *Id*.

[15] Lischer, *supra* note 4, at 491–93; "But what of the case where a person solicits credit with a spendthrift trust already in hand? Of course, debtors could again respond that lenders extend credit with their eyes open and that they are savvy enough to distinguish exempt from nonexempt property when they see it. But one criticism of disabling restraints (which like most others originated with Gray, although it has been often repeated since) is that spendthrift trusts operate to *hoodwink creditors*. Because they clothe potential debtors with the 'appearance' of affluence, lenders are led to believe that beneficiaries are creditworthy, when in truth they are not." Hirsch, *supra* at note 4, at 63 (emphasis added).

[16] John K. Eason, *Developing the Asset Protection Dynamic: A Legacy of Federal Concern*, 31 HOFSTRA L. REV. 23, 23–24 (2002). Please note that all the concerns listed here are amplified in the DAPT debates discussed *supra*.

However, unlike in DAPTs, there is a more positive rationale to explain spendthrift trusts. Some have credited the benefit of the spendthrift trusts to be that of "benevolent paternalism;" the idea that a settlor can gift money to "their imprudent or profligate children."[17] A theoretical example of this is a parent wishing their irresponsible child to inherit the parent's fortune but with safeguards to prevent reckless spending or other less-than-desirable behavior. DAPTs have no corresponding third-party concern to strengthen the reasoning for their existence.

B. *Introduction to DAPTs*

DAPTs originated in Alaska and Delaware and negate the idea that settlors cannot utilize spendthrift protections for their personal benefit to prevent creditors from accessing assets in self-settled trusts.[18] It is important to understand at the outset that DAPTs and their counterpart, OAPTs, are primarily an asset scheme for the very wealthy. It is reported that an OAPT settlor must have a net worth of $500,000 and that a million-dollar trust has fees of at least $15,000.[19] In addition to normative public policy questions of whether this form of protection is in the general public welfare, it is also a benefit that is highly skewed to the upper economic classes. The creation of DAPTs radically shifted the long-standing idea that it was "unjust" to allow an "individual to simultaneously shield assets and enjoy benefit or control over them."[20]

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[17] Steward E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1043–44 (2000).

[18] Wagenfeld, *supra* note 4, at 843–44.

[19] Brennan *supra* note 7, at 765–66.

[20] Wagenfeld*, supra* note 4, at 843–44. "On the opposite side of the ledger, support for recognition of the spendthrift provision comes from two perspectives. From the settlor's perspective, enforcing the spendthrift provision grants the settlor the autonomy to make, in effect, a conditional gift. The gift of a spendthrift interest in a trust is conditional in the sense that the settlor intends to make the gift only if (1) the beneficiary cannot voluntarily alienate or transfer the spendthrift interest and (2) the spendthrift interest cannot be involuntarily alienated or transferred to (or otherwise benefit) the creditors of the beneficiary. From the beneficiary's perspective, enforcing the spendthrift provision protects the beneficiary from improvidence. This argument is not an autonomy argument as to the beneficiary; to the contrary, it manifests a paternalistic attitude toward the beneficiary that provides an advantage to the public by preventing the beneficiary from becoming a public charge." Lischer, *supra* note 4, at 493.

Of the nineteen states that have enacted DAPT statutes, all but one requires the trust to be irrevocable to be valid. Oklahoma's provision is even more settlor-friendly, allowing the trust to be revoked by the settlor but still disallowing creditors from using litigation to access the assets.[21] This means that a settlor can set up this instrument but later remove his or her assets from the restrictive trust at will. These specific provisions get closer to what the "ideal" DAPT would look like for the settlor. Ideally, a DAPT "perfectly" protects settlors against creditors while allowing them full control and enjoyment of the assets, including later having the freedom to disband the trust. The only provisions missing that a settlor might desire in Oklahoma case would be favorable federal income and estate tax laws.[22]

While not the main focus of this note, it is important to mention that there are still concerns of the enforceability of a DAPT should the settlor reside in a state that considers such structures to be against public policy. The Full Faith and Credit Clause and the Contracts Clause of the U.S. Constitution have both been presented as litigation stumbling blocks to the enforcement of such provisions.[23] The Full Faith and Credit Clause poses problems in that usually, "a judgement rendered against a debtor in a non-DAT state" should be given equal weight in a DAPT state.[24] Likewise, the Contracts Clause can disempower a DAPT statute by proving that it infringes upon prior made contracts.[25] The Full Faith and Credit Clause is likely a stronger argument. Though the Contract Clause argument is novel, it is more than likely to be counterargued that the contractual rights themselves are not infringed upon but rather the contractual remedies.[26] Regardless, this note will proceed assuming they are enforceable, leaving this debate to other authors.

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[21] Nicole F. Stowell et al., *The Use of Wills and Asset Protection Trusts in Fraud and Other Financial Crimes*, 65 DRAKE L. REV. 509, 543 (2017).

[22] *See* Lischer, *supra* note 4, at 501.

[23] Stowell, *supra* note 21, at 544–55.

[24] Trent Maxwell, *Domestic Asset Protection Trusts: A Threat to Child Support*, 2014 BYU L. REV. 477, 488–89 (2014).

[25] *Id.*

[26] *Id.*

I. OFFSHORE SELF-SETTLED ASSET PROTECTION TRUSTS COMPARED TO DAPTS

A. *Comparison to Offshore APTs*

Before DAPTs emerged in the U.S., OAPTs were the only similar structure for asset protection that allowed the benefit of the assets to remain with the settlor. OAPTs have their own set of disadvantages, but in terms of asset protection, they are incredibly powerful vehicles.[27] Generally, an OAPT includes some standard trust provisions, including trustees, a trust protector, and beneficiaries. However, they also likely include specific provisions to exclude certain persons, an anti-duress clause that disallows distributions of the trust in the event one of the beneficiaries is experiencing financial pressure from creditors or other sources, and a provision providing for the removal of the trust from the relevant jurisdiction.[28] In comparison, a DAPT is much simpler to implement (likely excluding some of the above criteria) and avoids very complicated IRS requirements imposed upon foreign trusts.[29] A DAPT also removes some of the uncertainties of placing a large amount of assets in a foreign country with different legal protections and cultural nuances.[30] The substantive nature of how it operates remains the same regardless of which nation state the trust resides within. Rather, the uncertainty of implementation and creditor protection merely changes depending upon the trust's physical location.

B. Overview of Existing DAPTs and Their Differences

As briefly mentioned earlier, the first DAPT provision was passed in Alaska in 1997, with Delaware following closely behind in the same year.[31] Alaska's legislative history indicates that the DAPT statute enactment was seen as an opportunity to stimulate their economy by encouraging financial institutions to invest resources into the state. The legislature did not, however, answer questions related to the potential

[27] *See* Lischer, *supra* note 4, at 503–04.

[28] *See* i*d.* at 506–8; Richard C. Ausness, *The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?*, 45 DUQ. L. REV. 147, 155–56 (2007).

[29] *See* Lischer, *supra* note 4, at 515–16.

[30] *See id.*

[31] *See* Brennan, *supra* note 7, at 769–70,772.

benefits or consequences of disallowing creditor claims.[32] The statute does allow creditors to "pierce" the trust in the event that the trust is set up by fraudulent transfer, the trust is revocable by the settlor "without consent of an adverse party," the trust includes a requirement of distributions to the settlor, or the settlor is "in default of thirty days or more on child support payments at the time of transfer."[33] Additionally, Alaska used their DAPT statute to abolish the rule against perpetuities.[34]

Delaware enacted a similar statute with a few notable differences. First, the Delaware statute specifically disallows DAPTs in the case of present creditors but not for future creditors. The statute also includes rules to prevent the settlor from having too much control over the trust and guidelines that must be met for the trust to be valid.[35] The Delaware statute also allows the recovery of assets from both intentional and constructive fraudulent transfers.[36] Along with this, the statute provides a list of preferred creditors, which gives priority of trust assets to former spouses and children, and tort victims.[37] One scholar commented, "[i]n this sense, the Delaware law is both conscientious in retaining the general public policy of protecting a special class of creditors, and progressive in expanding this class to include tort victims."[38]

Alaska and Delaware are specifically mentioned, as they were first movers in the DAPT space however, many other states have since enacted such legislation. One firm's ranking of the relative worth of DAPTs lists Nevada, South Dakota, Ohio, Missouri, New Hampshire, and Tennessee as the top five in terms of state laws that are beneficial to settlors, with

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[32] *See* Wagenfeld, *supra* note 4, at 857–60.

[33] Brennan, *supra* note 7, at 769–70.

[34] *See* Wagenfeld, *supra* note 4, at 851-52.

[35] Brenna, *supra* note 7, at 772–73. "First, Delaware retains the rule against self-settled spendthrift trusts with regard to present creditors, but repeals it in relation to future creditors. Delaware rule also places limitations on the settlor's control over the trustee and distributions from the trust. It strictly requires that a qualified disposition (Delaware's term for trust) meet the following conditions: (1) expressly state that Delaware law governs; (2) have a spendthrift clause; and (3) be irrevocable. Thus, creditors who wish to pierce a Delaware trust must first prove that the trust does not meet at least one of these three requirements." *Id.*

[36] *See id.* at 855–57.

[37] *See* i*d.* at 773.

[38] *See id*.

New Hampshire and Tennessee tied for fifth.[39] Of these six states, none have protection for "preexisting tort exceptions" or exceptions for other creditors one might wish to include for policy reasons. Missouri is the only exception with some provisions for state and government claims.[40] The longest statute of limitations for existing creditors is four years and the shortest is one and a half years.[41] Nevada stands out as worthy of individualized examination; not only do they have no state income tax, they also disallow all spouse and child support claims.[42] On the other end of the spectrum, Hawaii, Minnesota, Mississippi, and Utah are ranked the lowest in terms of value to settlors.[43] The main difference between the highest and lowest ranked states appears to be at least somewhat premised on state income tax, provisions for alimony or child support, and some form of tort creditor allowances.[44]

II. PUBLIC POLICY DEBATE

Policies in Favor[45]
1. Protection from Meritless Claims/Excessive Litigation 2. Indirect Subsidy to the Financial Services/Legal Services Industries of the State 3. Creates Efficiencies in the Credit Marketplace 4. Creates Easier Ways of Complying with the IRS Than Offshore APTs 5. Creates a Sense of Responsibility in Creditors When Lending 6. Ensures Trust Money Remains Within the U.S. Borders

The first relevant argument in favor of DAPTs focuses on legal liability implications within the U.S. is the liability system "permits opportunistic plaintiffs (and their imaginative counsels)" too much leeway

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[39] Law Offices of Ashins & Associates, LLC, *State Rankings Charts*, (last visited Nov. 2, 2020) [hereinafter "Ashins & Associates"], https://db78e19b-dca5-49f9-90f6-1acaf5eaa6ba.filesusr.com/ugd/b211fb_8281d9df73e7457998ad5605a5e9f060.pdf.

[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *See* Lischer, *supra* note 4. Note that the following arguments are representative of many of the cited scholars but are like those of Lischer.

to successfully sue.[46] This may be a particularly relevant psychological motivator for DAPTs, as there is strong assumption that these are specifically wise financial structures for protecting doctors, or like professionals, from malpractice claims.[47] Despite a logical coherence to this argument, it is far from clear protection is afforded or appropriate through trusts. First, it is unclear the "system is so meritless" to require such dramatic asset protection, and the existing case law of creditors suing DAPT settlors includes no examples of such a meritless claim.[48] That is to say, there are no examples of such a case where a meritless suit against a doctor or otherwise innocent settlor occurs. Of course, this could be because the DAPT structure is so effective that it preemptively stems would be suits. Secondly, it is likely that flaws in the liability law system should be remedied through other legislative means instead of creating a more general liability exclusion that over encompasses potential victims of frivolous claims.[49] However, it is worth noting some argue many decades of attempting to alter the liability system to be more even has failed.[50] So, they reason, "self-settled spendthrift trusts may be a legitimate way to deal with this problem."[51]

Alternatively, one professor argues the system of civil liability is being destroyed because individuals have found ways to insulate themselves from money orders.[52] Another academic responded to this argument by noting OPATs and DAPTs "are just one way to make oneself judgement-proof from creditors."[53] So, they reasoned, it was illogical to deny this option simply because there are other ways of skirting debt.[54] More simply, because debtors have found numerous ways to protect their assets, this should likewise be allowed. This logic is incoherent. There are

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[46] *Id*. at 526.

[47] James J. White, *Fraudulent Conveyances Masquerading as Asset Protection Trusts*, 47 UCC L. J. 4, § 1 (2018).

[48] Lischer, *supra* note 4, at 527. For example, some of the litigants include a Ponzi scheme, a sophisticated settlor taking a large stock market risk, a transfer of assets under a divorce, and a transfer to escape a contractual obligation. *Id.*

[49] *Id.* at 528.

[50] *See* Lischer, *supra* note 4.

[51] Ausness, *supra* note 28, at 188.

[52] *Contra* id. at 184–85. (*citing* Lynn M. Lopucki, *The Death of Liability*, 106 YALE L. J. 1, 14–38 (1996).

[53] *Id.* at 185.

[54] *Id.*

no policy reasons to allow one negative thing to occur simply because other forms of irresponsibility exist, should this be the conclusion. This line of reasoning is evident in many policies "pros and cons" of DAPTs but never acknowledges the problem of setting a limit to the benefit and detriment controversy.[55]

Secondly, a common rationale for the enactment of DAPTs, as seen in the Alaska legislative history, is the idea enacting such a statute will draw financial services and trust business to the state, providing a stimulus. [56] A higher-level, more theoretical critique to this argument is that the initial benefits to this business venture entering the state "are captured by the financial institutions that can serve as trustees of the APTs, the lawyers and other advisors who implement the APTs, and the settlors of the APTs."[57] Only after the funds flow through these entities does the state recognize a financial gain. Following the same line of reasoning plaguing many other subsidy programs, this critique focuses on difficulties in measuring the overall benefits provided by a subsidy and the fact that the subsidy often requires more money than is efficient to create a positive net benefit. In any event as to recapture, states have no system to measure whether these laws have created a financial benefit at all. For a system designed to assist in bringing business to the state, it is curious that there is no comprehensive tracking to see if the claims economically benefit the state in question. Notably, this was the main motivation of the passage of the Alaska DAPT provisions; however, there is little to no evidence that the hope of being a financial center for asset protection has been realized.[58] This is partly because "anonymity and confidentiality" are some of the core benefits of a trust.[59] One author cited a 2002 study that said of the 870 trusts for non-Alaska residents, 310 were DAPTs.[60] Another 125 DAPTS existed at that time for Alaska residents.[61] The same author concluded that OAPTs still maintained their attractiveness for "maximum creditor protection," so Alaska's trust business had "shifted to tax reduction" primarily.[62] That is to say, it is unclear that Alaska recognized much financial gain from this venture. They have no system to determine the

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[55] *Id.*

[56] Lischer, *supra* note 4, at 530.

[57] *Id.*

[58] Timothy Lee, *Alaska on the Asset Protection Trust Map: Not Far Enough for a Regulatory Advantage, but too Far for Convenience?*, 29 ALASKA L. REV. 149, 172–73. (2012).

[59] *Id.* at 172.

[60] *Id.*

[61] *Id.*

[62] *Id.* at 172–173.

overall financial benefit and no income tax on such trusts, so there is little data to identify the reality of their situation.

Third, it can be argued that DAPTs create a sense of autonomy between debtors and creditors by forming a more efficient debt marketplace.[63] The most obvious critique of this idea is that it assumes debt is always negotiated to have the most efficient terms rather than recognizing that consumer debt is the primary debt-related issue regarding DAPTs.[64] Consumer debt, such as credit card debt, is unlikely to include individualized negotiations of terms.[65] This argument also perhaps naively assumes that lack of personal liability will create a "better" credit system. Rather, like in the case of other forms of low to no-liability debt such as non-recourse debt, it more than likely increases the opportunities for tax fraud and self-dealing. Such actions do not create an economic benefit for the public at large but rather the debtor (in the present case, the beneficiary). Put more simply, there is already a significant volume of tax cases where taxpayers have used nonrecourse loans to constructively purchase an physical asset and take tax deductions before defaulting and forfeiting the building to the lender.[66] Nonrecourse loans are debt instruments where the borrower has no personal liability for default. Rather, foreclosure or recapture of the asset is the only recovery tool available to the lender. This set up is analogous in the fact that the borrower has no personal liability and therefore can engage in more complex, risky, and imprudent borrowing to create financial benefits such as tax deductions. For example, a DAPT settlor and beneficiary could take out a similar

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[63] Lischer, *supra* note 4, at 532.

[64] *Id.* at 532–33

[65] *Id.* at 553.

[66] *See Crane v. Commissioner*, 331 U.S. 1 (1947) (holding that a cancellation of non-recourse debt is income to the debtor. The court treats debt even without personal liability in the same manner as recourse debt); *Commissioner v. Tufts*, 461 U.S. 300 (1983) (holding that the ruling from *Crane* stands even when the fair market value of the property is well below the non-recourse debt. The court will assume the debt is legitimate to prevent tax evasion); *Estate of Franklin v. Commissioner*. 64 T.C. 752 (1975); William Joel Kolarik II & Steven Nicholas John Wlodychak, *The Economic Substance Doctrine In Federal and State* Taxation, 67 TAX LAWYER 715, 770 n. 301 (2014).

loan utilizing the same apparent wealth from their trust without risking losing the proceeds of the trust. While the IRS has limited this formation of tax shelters, they have not completely eradicated their existence to preclude savvy tax promoters from rekindling their efforts. Whether DAPT beneficiaries will indeed use the financial instrument in such a way is not ascertainable however, it does present just one example of how this structure perpetuates the funneling wealth and security and fails to create an overall good for the public at large but rather creates a risk to the public. Hawaii, Indiana, and Wyoming do not suffer from this concern as severely. They are the only states with DAPT provisions that also allow the trust to be pierced in the event the settlor listed the trust as an asset to secure financing.[67] It is unclear why states would not provide this as a provision in their legislation unless they are attempting to provide the friendliest of terms to a settlor.[68]

Fourth, and most persuasively, the DAPT tax structure is significantly easier to comply with than OAPTs.[69] This improvement in reporting could be attributed to IRS complexities specific to offshore funds but is also likely a response to the fact that DAPTs have more third-party reporting that incentivizes taxpayers to be honest when filing their returns.[70] While the federal tax system may benefit from instituting this statute, it seems unlikely to motivate state legislatures too severely. State income tax could be collected more effectively if they used DAPT distributions from OAPTs.

Fifth, and least persuasively, it could be asserted that removing recovery protections from creditors could create a greater sense of accountability and care when deciding to lend funds.[71] Similar to the argument for the broken liability system, it is unclear if it is efficient to incentivize lender responsibility through a DAPT schema. This note agrees with Emeritus Professor Lischer's argument that lender's responsibility to give credit with care to those with sufficient resources to pay back the loan should not depend on the fear that a DAPT will prevent recovery.[72]

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[67] Ashins & Associates, *supra* note 39, at 19, 76.
[68] *Id.*
[69] Lischer, *supra* note 4, at 533.
[70] *Id.* at 533–34.
[71] *Id.* at 534.
[72] *Id.*

The final policy justification examined here observes that there is an extremely large amount of money estimated to be held in OAPTs (ranging from billions to trillions of dollars) so the creation of DAPTs prevents this loss of funds to OAPTs.[73] This argument is stronger than any individual state's claim that DAPTs bring significant funding to their specific tax base. Rather, stemming the flow of money outside the border, where it can never be reached, is an important consideration specifically on public policy grounds.[74] At least, if the money is to remain within the U.S. jurisdiction, courts have the chance to invalidate trusts in the event of truly fraudulent dealings.[75] However, DAPTs do not merely capture APT money but also lower the barriers to entry for even greater amounts of money to be protected from creditors in APTs.[76] Lee points to the precise benefit to DAPTs having existing asset protection schemes, but they are primarily beneficial to the very wealthy, including OAPTs.[77] APTs instead provide similar services at a lower cost of entry.[78] The Alaska legislature considered this point when choosing to enact their statute.[79] First, it is not clear that this claim is true. The ability to alienate oneself from one's assets is not a reality many can realize without substantial wealth to bear the risk.[80] Put more simply: average people cannot risk giving up two thirds or more of their assets to a trust. While DAPTs may reach slightly fewer wealthy people than OAPTs, they are not devices for people without significant assets.[81] Similar to other critiques, the adage "two wrongs don't make a right" is a more fitting response. The United States' non-negligible interest in retaining trust business so its courts can correct truly inappropriate trust set ups does not necessarily justify APTs' existence.[82] There is no evidence that DAPT provisions have slowed the OAPT business. Instead, it is more likely that the most objectionable of creditors

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[73] Cheyenne VanKirk, *Domestic Asset Protection Trusts: Ushering in the Klabacka Era*, 42 SEATTLE U. L. REV. 1559, 1574 (2019).

[74] *Id.*

[75] *Id.*

[76] Lee, *supra* note 58, at 156.

[77] *Id.* at 153.

[78] *Id.* at 155.

[79] *Id.* at 156.

[80] *Id.* at 155.

[81] *Id.*

[82] *Id.* at 157–58.

have continued to send their funds overseas.[83] It is likely that DAPTs mostly involve settlors wishing to avoid smaller classes of creditors because of the fraud risks associated with OAPTs and DAPTs respectively.[84] In other words, the "worst" settlors likely use OAPTs for maximum legal protection, while DAPT settlors should still be monitored for using the trust system to commit abuses.

Policies Against[85]
1. Discharges Moral Obligations 2. Exists Only to Help Avoid Paying Debts 3. Incentivizes Risky Behavior by Creating a Moral Hazard 4. Benefits Only for the Wealthy 5. Inappropriately Harms Involuntary Creditors (Spouses, Children, and Tort Victims) 6. Interjurisdictional Competition of States is Not an Effective Regulator of this Behavior

The first argument against DAPT adoption is foreshadowed in the critiques of the pro-policy arguments. That is, the DAPT structure creates misplaced incentives to fail to complete the moral duty of repaying debts and making wise business decisions.[86] One scholar argues this is a weak argument because estate planning generally tries to avoid the repayment of creditors and therefore DAPTs are only a small step farther in an already existing set of incentives.[87] This critique overstates the situation. While trust creation does generally seek to avoid liability towards creditors, the traditional trust setup allows a settlor to prevent their beneficiaries' poor financial decisions to result in creditors benefiting from the trust's assets. This may or may not incentivize the third-party beneficiary to avoid moral obligations, however, it is not the settlor avoiding the debtors.[88] DAPTs are a conceptual leap in allowing the debt-creator to avoid self-imposed

[83] *Id.* at 158.

[84] It should be noted that I do not accept that smaller creditors are less deserving of their proceeds than the large class, but I recognize that DAPTs prove feasible in many cases.

[85] Lischer, *supra* note 4 (policies one through five); Sterk, *supra* note 17 (policy six). *See generally* Hirsch, *supra* note 1.

[86] Lischer, *supra* note 4, at 536.

[87] *See id.* at 534–35.

[88] *See id.*

obligations.[89] For a variety of reasons, allowing an individual to set up this structure with the express intent of defrauding others in the future negates their validity in a stronger way than the traditional spendthrift provisions.[90] It is notable that many states have fraudulent transfer provisions.[91] The fear here is that this structure will allow or incentivize future bad dealing even if it prevents an initial fraudulent transfer.

Second, DAPTs and OAPTs have little rational basis outside of avoiding creditors and preventing court involvement. State legislatures have additional motives in enacting the statutes but settlors likely have few motivations beside liability-avoidance.[92] One court stated that OAPTs were designed "to frustrate and impede the United States courts by moving their assets beyond those courts' jurisdictions."[93] Another court said "the sole purpose of the anti-duress clause in a trust appears to be an aid to the settlor to evade contempt while merely feigning compliance with the court's order."[94] One scholar noted after reviewing various "Asset Protection Planners" and their advertisements for DAPTs that "multiple pages of internet listings, some subtle, some strident, and some with false denials, make plain that keeping assets out of the hands of creditors, particularly tort plaintiffs and former wives, is a principal purpose of these trusts."[95] It is unclear why this particular motivation, that of credit avoidance, as articulated in the offshore trust counterparts, should be incentivized beyond the already existing asset protection vehicles in place. It does not appear to have any justifiable claims that this is in the general public.[96]

Echoing the earlier non-recourse debt discussion, the third policy argument disfavoring DAPTs is that they encourage a "moral hazard of

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[89] *See id.*

[90] *Id.* at 536–37.

[91] *Id.* at 516.

[92] *Id.* at 588–89.

[93] Ausness, *supra* note 26, at 182 (quoting *Fed. Trade Comm'n v. Affordable Media*, 179 F.3d 1228, 1240 (9th Cir. 1999)).

[94] *Id*. (quoting *In re Lawrence*, 279 F.3d 1294, 1299 (11th Cir. 2002)).

[95] White, *supra* note 42, § 1.

[96] Notably, only Wyoming requires personal liability insurance "equal to the less of $1,000,000 or value of trust assets." David G. Shaftel, *Twelfth ACTEC Comparison of the Domestic Asset Protection Trust Statutes*, at 71 (Aug. 2019), https://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf.

risk-generating behavior by the beneficiary . . . ."[97] The spirit of this fear is evident in a number of arguments and public perceptions regarding trusts more generally, such as in, for example, the public perception and colloquial term of "trust fund babies." This phrase generally illustrates a negative social connotation of a lack of responsibility or desire to earn a living[98]. DAPTs in many ways more aggressively promote this negative stereotype of settlors as avoiding responsibility while protecting those around them.[99] In and of itself, this is not evidence to disallow these structures. However, it speaks to the general lack of policies supporting the creation and adoption of APT legislation. Additionally, because "many U.S. civil penalties are monetary in nature," the very nature of asset protection introduces a risk of hazardous behavior without a legal remedy.[100] In stronger terms, this argument likewise shows a potential encouragement of a lack of care or outright fraud.[101]

Fourth, and most convincing in the public policy sense, such trust structures only benefit the wealthy.[102] As previously mentioned, the administrative and transactional costs of setting up this structure are too expensive for less-well-off settlors to find the system worth it, even in the case of DAPTs which are less expensive than OAPTs.[103] Ostensibly, if the structure is truly designed to stem frivolous lawsuits or to provide protection to professionals such as doctors, which is the most benign explanation, only protecting the wealthiest of the targeted class of people makes little sense. Specifically, it raises a normative question of why those with the greatest capacity to fight such suits should receive more protection than those with fewer resources to lose. Perhaps the wealthiest defendants experience more claims in proportion to their wealth, but readily available empirical evidence does not support such a conclusion.[104]

Fifth, the most sympathetic anti-DAPT argument with little recourse is the idea that involuntary creditors are inappropriately harmed

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[97] Lischer, *supra* note 4, at 542.

[98] *See* Hillary Hoffower, *People assume trust-fund babies are spoiled 20-somethings born with silver spoons—but they're not always who you think*, Business Insider (Dec. 30, 2018, 5:23 AM), https://www.businessinsider.com/what-is-a-trust-fund-baby-2018-6.

[99] *See* Danforth, *supra* note 2, at 318.

[100] Lee, *supra* note 58, at 154.

[101] *Id.*

[102] *See* Lischer, *supra* note 4, at 544–45.

[103] *See generally* Lischer, *supra* note 4.

[104] *Id.*

by the DAPT structure.[105] Remember, involuntary creditors encompass the class of creditors who did not voluntarily enter into the debt arrangement.[106] Prior spouses seeking alimony, children relying on child support, and tort victims are the most common examples of this class of people.[107] In the classic narrative of the "bad" settlor, the more sophisticated holder of assets can transfer the bulk of their wealth to a DAPT and continue to live a lavish lifestyle but avoid genuine claims.[108] Of the nineteen states with DAPT legislation, ten allow alimony claims, seventeen allow child support claims,[109] twelve allow child support claims that did not predate the transfer of assets to the trust,[110] and ten allow either tort or other creditor claims to be brought.[111] This is not to say all DAPT statutes are plagued with involuntary creditor problems, but the remedies or allowances for legal interference are sporadic, and at best, involve costly litigation. In many ways, spendthrift trusts best articulate this issue. However, its inconsistent policy rationale appears to be more problematic because the settlor and the beneficiary are the same entity. Figure 2 below provides a helpful summary of state law provisions regarding certain creditors' forms, specifically identifying states that allow involuntary creditor claims to pierce the trust.[112]

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[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] Note that South Dakota only allows this if there is indebtedness at the time of the asset transfer to the fund. *See* Ashins & Associates, *supra* note 39.

[110] Shaftel, *supra* at note 96, at 5, 17, 28, 41, 52, 63, 75.

[111] *Id.*

[112] Shaftel, *supra* at note 96.

State	Date Enacted	No Protection for Child Support Claims	No Protection for Alimony	No Protection for Tort Victims	No Protection for Other Creditors
Alaska	4/1/97	Yes*	No	No	No
Connecticut	1/1/20	Yes*	Yes*	Yes*	No
Delaware	7/9/97	Yes	Yes	Yes*	No
Hawaii	7/1/11	Yes	Yes	No*	Yes[113]
Indiana	3/8/17	Yes	No	No	Yes[114]
Michigan	3/8/17	Yes*	No	No	No
Mississippi	7/1/14	Yes	Yes*	Yes*	Yes[115]
Missouri	6/11/05	Yes	Yes	No	Yes[116]
Nevada	10/1/99	No	No	No	No
New Hampshire	9/16/17	Yes	Yes	No	No
Ohio	3/27/13	Yes	Yes*	No	No
Oklahoma	6/9/04	Yes	No	No	No
Rhode Island	7/1/99	Yes*	Yes*	Yes*	No
South Dakota	3/2/05	Yes*	Yes*	No	No
Tennessee	7/1/07	Yes	Yes*	No	No

[113] "Yes, secured loans to the transferor based on express or implied representations that trust assets would be available as security in the event of default; also, the transferor's tax liabilities to the State of Hawaii. HRS § 554g-9(3)&(4)." *Id.* at 19.

[114] "Yes. Assets that are listed on an application or financial statement for a loan are excepted from protection. In addition, if those assets are transferred to a Legacy Trust, the Settlor must send written notice within fifteen (15) days after the transfer to the lender, showing the name of the Settlor, the description of the asset, the name of the trustee and the date the transfer was made. IC 30-4-8-16(b). Also excepted from the Legacy Trust would be any assets that are subject to an agreement where the disposition is prohibited by the terms of that agreement." *Id.*

[115] "Claim not extinguished (1) if creditor is state of Mississippi or any political subdivision thereof, (2) for any creditor in an amount not to exceed $1,500,000 if the settlor failed to maintain a $1,000,000 general liability policy." *Id.* at 29.

[116] When there is another governmental claim, and their governing law supersedes. *Id.*

Utah	12/31/03	No[117]	No[118]	No	No
Virginia	7/1/12	Yes	No	No	Yes[119]
West Virginia	6/8/16	Yes	No	No	Yes[120]
Wyoming	7/1/07	Yes	No	No	Yes[121]

Figure 2

**These states disallow protection when there is a claim, incidence, or delinquency in payments prior to transfer (or some combination of factors thereof)*

An existing counterpoint to this example comes from Senator Justin C. Jones of Nevada who predicted that a settlor with this much wealth would not have children or a spouse that "would end up on welfare."[122] He followed this statement with a much stronger argument that at least one-half to two-thirds of a person's assets should remain outside the trust for fraudulent transfer reasons.[123] The argument that spouses and children of the wealthy will not have financial needs that

[117] Must give notice of creation of trust. *Id.* at 63.

[118] *Id.*

[119] "No spendthrift protection against: (A) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust. Va. Code § 64.2-744(B). (B) the United States, the Commonwealth, any city, county, or town. Va. Code § 64.2-744(C). (C) claims under a statute or regulation of the United States or the Commonwealth that requires a beneficiary to reimburse the Commonwealth or any agency or instrumentality thereof, for public assistance. Va. Code § 64.2-745(A)." *Id.* at 64.

[120] "The spendthrift provision is unenforceable against (1) judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; (2) claim of State of WV to the extent a statute so provides; and (3) claim of the United States to the extent federal law so provides. W. Va. Code § 44D-5-503(b)." *Id.* at 64.

[121] For a qualified spendthrift trust, "Yes (1) Financial institution with which the settlor has listed qualified trust property on the financial institution's application or financial statement used to obtain or maintain credit from the financial institution other than for the benefit of the qualified spendthrift trust; (2) property of a qualified spendthrift trust that was transferred to the trust by a settlor who received the property by a fraudulent transfer. W.S. § 4-10-520(a)(ii) & (a)(iii)." *Id.* at 76. But not for a discretionary asset protection trust. *Id.*

[122] Vankirk, *supra* note 73, at 1571; Hearing on Assemb. B. 378 Before the Nev. S. Comm. on Judiciary, 2013 Leg., 77th Sess. 6, at 6 (Nev. 2013), https://www.leg.state.nv.us/Session/77th2013/Minutes/Senate/JUD/Final/1035.pdf [https://perma.cc/4VLS-RXHM].

[123] Vankirk, *supra* note 73, at 1571–72.

should be satisfied by a settlor seems without logical reasoning. However, in theory, the secondary argument that at least a portion of a settlor's assets will remain outside the trust is more acceptable. Regardless, allowing involuntary creditors to access a part of a person's wealth while still protecting a significant portion does not seem tenable. That is to say, the fact that some involuntary creditors will be able to be at least partially satisfied does not negate the fact that this set up still allows for significant portions of one's assets to be impermissibly protected.

Notably, the provided examples of involuntary creditors are not the sole potential claimants. In the oft cited case of *F.T.C. v. Affordable Media*, the settlors of an OAPT defrauded investors in a Ponzi scheme but because their assets were in the Cook Islands, there was no recourse for the investors swindled out of their money.[124] This case represents the problem well associated with APTs where the settlors theoretically have a lot of power over the trust but there is not a legal resource to get to the funds. Therefore, this idea of significant assets being left outside an APT does not address all imaginable scenarios. Certainly, the plaintiffs in *Affordable Media* were not able to sufficiently satisfy their claims. Though that case involved an OAPT, it is merely the clearest example of potential fears associated with DAPTs.

Finally, and interestingly, there is a claim that DAPT creation by the states themselves is not well regulated by interstate competition.[125] That is to say, states generally "compete" for trust business to bring funds into their jurisdiction through enacting favorable terms.[126] In theory, interjurisdiction competition "assume[es] that is possible to identify a 'representative [resident] consumer'–much like the shareholder in a business firm–whose interests the state should maximize."[127] To explain more simply, the relevant literature hypothesizes that a state, like a business, can conduct an effective cost-benefit analysis of whether the

[124] *F.T.C. v. Affordable Media*, 179 F. 3d 1228, 1231–32 (9th Cir. 1999) (involving a husband and wife that used a telemarketing scheme to solicit investments that could not return the profit as promised. The court held that they were required to return the money, but because the trust was located internationally, there was no way to compel the return of the money).

[125] Sterk, *supra* note 17, at 1038.

[126] *Id.*

[127] *Id.* at 1057 (citing Wallace E. Oates & Robert M. Schwab, *The Allocative and Distributive Implications of Local Fiscal Competition*, in COMPETITION AMONG STATES AND LOCAL GOVERNMENTS 127, 130 (Daphne A. Kenyon & John Kincaid eds., 1991).)

trust is a "welfare-maximizing" action.[128] This idea is conceptually clear but fatally flawed in implementation. The state's best interest is far from simple to determine, and public officials are not perfect decision makers.[129] Professor Stewart Sterk, the scholar presenting this critique, adds,

> [d]ue to the externalities and agency costs associated with asset protection and perpetual trusts, state legislatures are unlikely to consider all the costs and benefits associated with trusts created in their states. Competition, however, does discriminate among rules. It will lead state legislatures to prefer rules that generate out-of-state costs. Rules permitting asset protection trusts fit this model.[130]

To conclude this critique, it is likely that competition will not provide enough of an incentive to ensure state legislatures respond to trust competition in a way that maximizes the benefit for all both because of misplaced incentives and information-gathering problems.

A. Conclusion from the Proposed Arguments For and Against DAPTS

A review of the proposed arguments for and against DAPTs reveals a complicated structure of anticipated benefits but little to no evidence those benefits are realized upon implementation of the statute.

First, the strongest argument against this particular trust set up is that involuntary creditors should not be precluded from accessing funds that are either rightfully theirs or that they are owed due to a restitution judgement. However, it is unclear that simply solving this portion of DAPTs justifies them as a more general policy matter. Trusts outside of this area have many more benign justifications including, at points in time, limiting estate and gift tax implications, protecting funds from third party creditors, and ensuring the funds are distributed across generations

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[128] *Id.*

[129] *Id.* at 1057–58. Public officials are notably influenced by other incentives such as maintaining campaign donations, enacting business-friendly policies, etc. *Id.*

[130] *Id.* at 1072.

appropriately. DAPTs lack many of these available rationales, and this should be thoroughly examined by the legislature prior to trust creation. When this complication is paired with the fact that these trusts likely are not financially feasible for anyone without significant assets, it becomes even less clear why a legislature should disadvantage creditors, one group in favor of DAPTs. This inequality and allowance to protect assets while incentivizing the moral hazard is hard to conceptually reconcile.

Finally, it is arguable that legislation regarding debt and protections from creditors should prioritize accountability and transparency. If there is a situation, and there are many, where debtors should be relieved of their obligations, the act of negating the debt should maintain the utmost visibility. In other words, even if it is arguable that DAPT settlors should be able to protect their assets from their debtors, it is not clear why providing an opaque system for such protection is the logical solution. The lack of data and notice to creditors is particularly problematic. If the liability system of consumer debt system is truly flawed and should result in protection, there are other conceptualizations of such systems that would allow the legislature to adequately understand the financial situation and whether the overall good was served.

III. ALTERNATIVES

If DAPTs are an imperfect or inefficient solution to liability system flaws, provide too much protection, and are inefficient market competitors, it begs the question of what should be done to remedy the problem. One possibility is to stop enacting the statutes and repeal the existing DAPT legislation. However, it is perhaps more difficult to rewind the spool than to put in safeguards going forward. Whatever the fate of DAPTs, the following section compiles a collection and critiques of scholarly ideas to retain the DAPT provisions but implement greater safeguards to prevent abuse.

A. *Changing the Legislative Structure*

The first alternative comes from Professor Adam Hirsch, a law professor at the University of San Diego. He argues that legislatures should prevent complete spendthrift protection. The general premise is that there should be statutory exceptions for certain involuntary creditors to access the trust.[131] Professor Hirsch advocates that, in addition to this idea, settlors should be allowed to name certain individuals who would

[131] Hirsch, *supra* note 1, at 82.

always be precluded from accessing the trusts.[132] This is particularly theorized to apply when the settlor already knows of a creditor when creating the trust and wishes to deny them access of the trust.[133] To summarize, this argument would allow involuntary creditors to access the trust unless expressly named. Justifications for this rule make more sense in the traditional spendthrift schema than in DAPTs. As mentioned earlier, the idea of paternalism to protect one's assets from say one's foolish children's decisions is an understandable motivation. However, there are almost immediate paradoxes and dilemmas.

For instance, the court in *Sligh v. First National Bank of Holmes County* unwound a spendthrift trust created for a son's benefit because his mother knew he was an alcoholic who consistently drove while intoxicated. He had previously been arrested and caused car accidents, so when a victim of his drunk driving sued him, the court invalidated the trust as a matter of public policy.[134] Notably, the Mississippi legislature overruled this through legislation six months later.[135] This note would argue that allowing a settlor to name a known creditor or group of creditors, as evidenced in *Sligh*, is an inappropriate policy decision as it openly negates accountability for actions without a rational justification. It is unwise to legislatively incentivize and allow settlors to encourage others, or themselves, to act recklessly without consequences. However, it should be noted that it is not an unprecedented position for legislatures to hold.

Conversely, this is not a perfect solution to implement in the DAPT sphere. Instead of settlors attempting to protect their assets from third-party creditors, the issue of accountability in allowing the escape of one's own creditors is far more problematic than that of a derelict child. Instead, this note proposes a general rule allowing the piercing of the trust by involuntary creditors, of all kinds and any re-existing creditors, involuntary or otherwise. This provision weakens the liability-reducing nature of the trust but retains the arguments that voluntary creditors should receive less protection as they should complete due diligence before lending money. In this way, it fits the more traditional "invisible hand" of

[132] *Id.*
[133] *Id.*
[134] David M. Repp, *Asset Protection (for the Rich and Not) in Iowa*, 56 Drake L. Rev. 105, 115–16 (2007) (citing *Sligh v. First Nat'l Bank of Holmes Cty.*, 704 So. 2d 1020 (Miss. 1997)).
[135] *Id*.

the market ideology that creates a survival of the fittest incentive structure. This proposal also rejects the idea of an exception rule for settlors because that is the very responsibility avoidance that should be stemmed. This idea is also not radical as many states have fraudulent transfer laws that disallow protection from existing creditors.[136]

Though providing relief to involuntary creditors does not solve all policy issues implicated by the avoidance of legitimate creditors, it comes closer to solving what has been referred to as "inequality before the law."[137] That is to say, it is socially inequitable that property held in trusts would receive more protection than "income which a man produces by his own toil and efforts."[138] Protecting those that do not choose to enter into these relationships with settlors comes closer to providing more equilateral protection than the existing articulation. Involuntary creditors should specifically not be harmed because DAPTs deny them relief without cause. Known creditors likewise lent money to a debtor without forewarning that they would not be able to recoup their costs because the debtor's assets would later be placed in a self-settled spendthrift trust. In either case, fairness, accountability, responsibility, and foreknowledge require these creditors to be allowed to absolve their claims.

B. *Federal Intervention*

The weaknesses identified in this note and elsewhere should encourage the federal government to continue to work towards enacting some sort of arching legislation to better the liability system (if one accepts the assumption that it is broken) and to strengthen bankruptcy and creditor provisions overall. One academic disagrees, saying that there is a long-standing tradition of Congress allowing states to select their own debtor provisions. These provisions have "survive[d] even a federal bankruptcy proceeding."[139] This assertion was coupled with the prediction that such legislation would be unnecessary because federal bankruptcy judges would utilize provisions of federal bankruptcy laws to invalidate APTs crashing the entire structure.[140] That prediction was made in 2000. Though bankruptcy is a common attack on the validity of APTs, the prediction of general invalidation does not appear to have come to fruition. However, the general idea that perhaps states should be allowed to determine their

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[136] *See* Ashins & Associates, *supra* note 39.
[137] Hirsch, *supra* note 1, at 93.
[138] *Id*. (quoting *Brearley Sch., Ltd. v. Ward*, 201 N.Y. 358, 373 (1911)).
[139] Sterk, *supra* note 17, at 1114–15.
[140] *Id*. at 1115.

own asset protection and creditor protection standards is worthy of individualized scrutiny and analysis, though outside the scope of this current work.[141]

C. *Corporate Veil Piercing Theory*

A student note from 2010 proposes an alternative and somewhat creative protection schema that would disallow a corporation's leadership from protecting their personal assets from their victims should the plaintiff successfully "pierce the veil."[142] The basic articulation of this idea is that when a plaintiff can meet the legal standards to pierce a corporate veil, which would allow the "corporate officers, shareholders, and directors to be held individually liable for corporate actions," DAPTs should not protect the leadership.[143] The note further suggests that common criteria to accomplish piercing the veil often is apparent in fraud or when the corporation is an "alter ego" of the owner or officer.[144] More simply, in the event a plaintiff can prove the corporation itself was used to commit fraud, with or without intent, the plaintiff will likely succeed. The note continues, "a corporate veil may be pierced (1) when the unity of interest and ownership that separates the corporation from corporate individuals is no longer present and (2) when adhering to the falsity of that separate existence between the corporation and individuals would promote injustice."[145] In theory, this sort of provision would create a statutory exception to DAPT spendthrift protections in the event a plaintiff receives an affirmative declaration from a court. Finally, the author justifies this position by mentioning that spouses, children, and tort victims already have some protections in this space.[146] Victims of corporate fraud or irresponsibility are just another class of involuntary creditors who experienced great harm at the hands of a sophisticated corporation or officer.[147]

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[141] *Id*. at 1114–15.

[142] Patrick M. Wilson, *Protecting Investors from Their Investments: Encouraging States to Make Assets in Domestic Asset Protection Trusts Available to Creditors Who Have Successfully Pierced the Corporate Veil*, 44 NEW ENG. L. REV. 791, 801 (Spring 2010).

[143] *Id*. at 800–01.

[144] *Id*.

[145] *Id*.

[146] *Id.* at 813.

[147] *Id*. at 814.

If it is easily accepted, as this note proposes, that involuntary creditors should be comprehensively protected against the shirking feature of DAPTs, this suggestion should not appear radical. Instead, this would require a small amendment to the previously proposed state or federal legislation.[148]

IV. CONCLUSION

In conclusion, the available suggestions for remedying issues within the DAPT structure are lacking. First, the suggestion to allow selective exclusion of creditors, but not overall protection, is not accepted by this work. Such a structure exacerbates issues of unfairness and self-dealing while simultaneously creating a host of constitutional issues. Second, while it is true the federal government has the capacity to alter the liability system, that process has been long, complicated, and contentious. Additionally, creating stronger debtor protections has ramifications beyond the scope of DAPT that may cause greater overall harm, in addition to invading upon an area of law traditionally regulated by the state. Finally, the corporate veil piercing theory is the easiest to accept and is a valid suggestion for state legislative amendment. While it does not address all the relevant policy considerations, it does reduce some of the aspects of self-dealing and unfairness presented by both the economic skew of DAPT settlors and also some of the issues of moral hazard.

There may be no sufficient way to address all the public policy concerns without repealing DAPT legislation; however, three general principles are suggested to guide legislative amendment to prevent the worst of abuses. First, DAPT legislation should not provide protection against existing creditors of any sort or involuntary creditors (from before or after the trust's creation) to ensure fairness. Second, reporting structures should be implemented to gauge how much overall financial good is brought to a state compared to the creditor's loss to ensure an overall economic benefit is realized. Finally, states should invite a wide selection of voices to participate in drafting their DAPT statutes, should they do so. Presuming DAPTs truly create a positive financial impact, this reality should be weighed against the needs of creditors and the general good of the public. Reviewing creditors' and other stakeholders' concerns prior to adoption is theorized to produce the most comprehensive and well-balanced DAPT provisions.

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[148] *Id*. at 815.