Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #109

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From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Wyoming Enters DAPT Legislation Arena**

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In our last LISI, we compared the Tennessee DAPT statute to some of the lead APT jurisdictions. This article compares the Wyoming DAPT statute to some of the lead DAPT jurisdictions. Because these LISIs focus on statutory comparisons, only minimal consideration will be given to the effectiveness of DAPTs in a litigation setting and instead concentrate on the statutory differences between DAPT jurisdictions.

How Most DAPT Statutes Work

We previously noted that are two approaches that DAPT statutes use: (1) the qualified disposition type of stand alone statute; and (2) incorporation of DAPT elements into a trust code. Theoretically, it would be possible for the second type of approach to be more protective because such a statute could provide for both discretionary trust and spendthrift protection.

In our previous LISI regarding the Tennessee DAPT statute, we discussed some of the problems when a qualified disposition statute is combined with the UTC. The Wyoming DAPT legislation has been incorporated directly into the body of the Wyoming UTC instead of having two separate pieces of legislation.. The presence of UTC language in

the Wyoming statute might result in similar problems as were reviewed in the Tennessee analysis.

There are, however, some key differences between the Wyoming UTC and most other UTC statutes. In this respect, we commend Wyoming's draftsmen, especially Douglas McLaughlin, for their efforts to make the Wyoming UTC a settlor friendly statute and to correct many of the UTC's asset protection and beneficiary centered code problems. Wyoming has made over 100 substantive changes, which has resulted in less than 50% of the Wyoming Trust Code being derived from the UTC.[1] This continues to be a work in process with many more major substantive changes anticipated for the next Wyoming legislature. Some of these changes partially address some of the problems we saw when the Tennessee DAPT was combined with the Tennessee UTC.

Key Elements of a DAPT Statute

The key areas of analysis are:

- Types of distribution interests protected
- Fraudulent conveyance issues
- Jurisdiction over the APT
- Protection of advisors
- Discretionary trust protection

There are of course other factors than those stated above that an estate planner should consider when forum shopping a DAPT situs.[2] For purposes of the Wyoming analysis, we have separated South Dakota from Delaware because South Dakota now has two statutes that help protect DAPTs: (1) the qualified disposition statute; and (2) SB 98 that applies to all trusts. While we consider Nevada a lead DAPT state, we have not included its statute in the analysis of the Wyoming DAPT legislation.

A. Types of Distribution Interests Protected

In our last LISI, we provided a short narrative of the different types of distribution interests: (1) discretionary trusts, (2) support trusts, and (3) mandatory trusts. We are therefore not repeating the definitions of these types of interests under common law. For additional information concerning the definitions of discretionary, support, and mandatory interests, see *The Effect of the UTC on Spendthrift Trusts*.[3]

The following tables compare the spendthrift protection given by various DAPT states to these three common law types of distribution interests. A "Yes" denotes the settlor's interest is protected, at least before distribution, and a "No" means that the settlor's interest is not protected.

Distribution of Income	**Alaska**	**Delaware**	**South Dakota**	**Wyoming**
Discretionary Interest	Yes	Yes	Yes	Yes
Support Interest	Yes	Yes	Yes	Yes
Mandatory Interest	No	Yes	Yes[4]	Yes[5]

Distribution of Principal	**Alaska**	**Delaware**	**South Dakota**	**Wyoming**
Discretionary Interest	Yes	Yes	Yes	Yes
Support Interest	Yes	Yes	Yes	Yes
Mandatory Interest	GRAT[6] Unitrust	5% GRAT[7] 5% Unitrust	Yes[8]	Yes[9]

B. Fraudulent Conveyance Issues and How the Lead DAPT Statutes Work

Under a qualified disposition act, unless a creditor is an exception creditor, the only claim that a creditor may bring is a fraudulent conveyance action. This approach specifically precludes any "dominion and control" creditor arguments.

	Alaska	**Delaware**	**South Dakota**	**Wyoming**
Limited to defraud	Yes	Yes	No	No
Length for Present Creditors	4/1	4/1	4/1.	4/1
Length for Future Creditors	4/0	4/0	4/0	4/1
Burden of Proof	Act Silent	Clear & Convincing	Clear & Convincing	Act Silent

A standard fraudulent conveyance rule allows avoidance of any transfer that "hinders, delays, or defrauds" a creditor. While direct authority regarding "hinder and delay" is sparse, what little exists indicates that transfers can "hinder" or "delay" without involving

fraud. Hence, Alaska and Delaware have a competitive edge over all other DAPT states on this point.

Under all of the DAPT states listed above, a present creditor must bring an action within four years of the transfer or one year of learning of the discovery of the DAPT. However, in all of these jurisdictions except Alaska, a future creditor must bring an action within four years from the date the property is conveyed to a DAPT or the claim is forever barred. Hence, there is no "date of discovery" rule available for future creditors in Alaska, Delaware, or South Dakota. This differs from the approach of the Uniform Fraudulent Transfer Act ("UFTA") that allows future and present creditors in an "actual fraud" case to invoke a "date of discovery" rule for purposes of determining when limitations periods commence. Because Wyoming's DAPT incorporates the UFTA rule, it thus has a one year "date of discovery" rule for many present and future creditors.

For comparison, note that Nevada has a two year primary limitations period, and only allows 6 months for certain creditors to invoke "date of discovery" tolling rules. Nevada's shorter date of discovery rule gives it an edge over all states on this point. However, Nevada's advantage may be neutralized in bankruptcy, as the Bankruptcy Code imposed a ten year limitations period in connection with certain fraudulent transfer claims against self-settled DAPTs and other vehicles.[10]

In determining whether a fraudulent conveyance has occurred, a plaintiff's quantum of proof can be important. Delaware and South Dakota statutorily impose an elevated "clear and convincing" standard. Wyoming's DAPT statute is silent on this point, so normal UFTA rules probably apply. However, there is very little case law on this point, although at least one case indicates that plaintiffs must prove a fraudulent transfer claim by clear and convincing evidence.[11]

C. Jurisdictional & Protection of Advisor Issues

Will a non-DAPT state follow a DAPT's state laws? Regarding out of state settlors, this has been a constant debate between those who believe that DAPT statutes will violate another state's public policy prohibition against self-settled asset protection trusts and those that believe that they DAPT will work for both in-state residents as well as out-of-state residents. Again, the purpose of this article is not to address this concern, but to instead examine how some of these DAPT statutes attempt to limit an out-of- state court's jurisdiction over the DAPT.

	Alaska	Delaware	South Dakota	Wyoming
Asserts Exclusive Jurisdiction Over Claims	Yes	Yes	Yes	No
Automatic Removal of Trustees	Yes	Yes	Yes	No
Protection of Advisors	Yes	Yes	Yes	Yes

Alaska, Delaware, and South Dakota all require that a fraudulent conveyance action must be brought in their respective state courts. Even, if the action is not brought within the DAPT state's forum (i.e., the non-DAPT state does not respect the jurisdiction provision), Alaska, Delaware, and South Dakota, provide for the automatic removal of the trustee if a foreign court does not follow these states DAPT law. Wyoming does not provide for automatic removal of trustees, but does give trustees a clear statutory right to resign if they wish.[12] (Presumably failure to resign could be a breach of fiduciary duty if continued service results in adverse legal consequences for beneficiaries.) Whether removal is automatic or voluntary, all of these states' DAPT statutes provide for the appointment of a new DAPT trustee. While it's uncertain whether the U.S. Supreme Court will uphold such provisions, these statutory provisions provide major hurdles for a creditor to surmount.

Some articles have voiced a concern that an attorney or advisor who drafts or assists in the creation of an asset protection trust may be subject to creditor liability claims. Assuming the attorney or advisor did not participate in a fraudulent conveyance or violate some other statute, case law does not appear to reflect these articles concerns. However, in order to further insulate attorneys and advisors, these lead DAPT states provide statutory protection for attorneys and advisors.[13]

UTC Discretionary Trust Issues – At Least 3 Major Components

In our last article we discussed the potential problems caused by the interplay between Tennessee DAPT statute and its version of the UTC. The example discussed was the common situation where a DAPT is created with the current beneficiaries including the settlor and the settlor's children; the settlor then goes through a divorce; and the settlor's estranged spouse obtains custody over the children. Can the settlor's estranged spouse now sue the trustee for a distribution on behalf of the children? If a discretionary beneficiary has an enforceable right to a distribution, then *of course the estranged spouse may sue on behalf of the children*, not as a creditor in her own right, but on behalf of a child beneficiary. As noted in our last LISI, we generally concluded that the UTC comment under § 814(a) most likely adopts the Restatement (Third) position that a beneficiary of a discretionary trust generally has an enforceable right to a distribution. If

this is the case, this may well be a major structural flaw in the Tennessee UTC that may also exist in the Wyoming UTC.

There are at least three components to discretionary trust protection, and all must be present to give beneficiaries the superior asset protection of a common law discretionary trust. Specifically, those components are:

1. A discretionary trust needs to be defined in the statute. Drafters need to know whether they can draft a discretionary trust that may be limited by an ascertainable standard.

2. The beneficiary's rights holding a discretionary interest are defined so that the beneficiary does not have an enforceable right to a distribution or a property interest.

3. Closely linked to point 2, the judicial review standard for discretionary trust supports that a beneficiary does not have an enforceable right to a distribution. The most common judicial review standard for a discretionary trust is that a court will only review a trustee's distribution decision if the trustee (1) acted dishonestly; (2) acted with an improper motive; or (3) failed to use the trustee's judgment.

In our last LISI, we noted that neither of Tennessee's DAPT or UTC satisfactorily addressed these issues. Unfortunately, the Wyoming DAPT addresses only the first issue. While the language in Wyoming's UTC is a bit confusing, we interpret relevant Wyoming UTC Sections affecting those three components as follows:

A. Component 1 and § 103(a)(xxix) and (xxx) – Delineating Discretionary Trusts

Wyoming UTC § 103(a)(xxx) defines a discretionary trust as a trust in which the trustee is not directed to make distribution but instead "is permitted to make discretionary distributions." Under sub-part (xxix), a discretionary distribution is defined where the trustee is not "directed" to make a distribution." Sub-part (xxix) also provides sample discretionary distribution language, such as the trustee "may" make distributions or allowing distributions "in the trustee's discretion." Sub-part (xxix) further states that a discretionary distribution may include "a standard of distribution or other guidance as long as the language or other guidance does not require the trustee to make a distribution." Accordingly, Wyoming gives clear guidance on key definitional matters.

B. Component 2 and §§ 504(b), (d) – Enforceable Rights or Property Interest?

Wyoming UTC § 504(b) and (d) prevent creditors of discretionary trust beneficiaries from compelling any distributions, except in cases of "abuse of discretion." However, this is not what creates the superior asset protection of a discretionary trust. Under common law, a discretionary trust's superior asset protection is because the beneficiary does not have a right to force a distribution, resulting in no creditor may step into the

shoes of the beneficiary. Unfortunately, the Wyoming UTC is silent on the legal effect of being classified as a discretionary trust. With little case law on point,[14] will a Wyoming court default to the new view of trust law created under the Restatement (Third) of Trusts - where seldom will a beneficiary not have an enforceable right to a distribution? This differs sharply from established precedent, which typically holds that a debtor's interest in a discretionary trust is a mere expectancy and not an enforceable or property right.[15] Missouri's UTC, which also allows self-settled DAPTs, addressed this second component of a discretionary trust by providing, "A beneficiary's interest in a trust that is subject to the trustee's discretion does not constitute an interest in property or an enforceable right even if the discretion is expressed in a form of a standard of distribution or the beneficiary is then serving as a trustee or co-trustee."[16] We suggest that Wyoming do something similar.

C. Component 3 and § 504(d) – What's Wyoming's Standard of Review?

As noted above, 504(d) seemingly lets discretionary trust beneficiaries compel distributions on grounds of abuse of discretion. This raises the question of what is an abuse of discretion under Wyoming law. On a positive note, realizing the problems with the "good faith standard" imposed by Section 814(a) of the UTC, Wyoming deleted this controversial section. However, with apparently no discretionary trust law on point regarding the judicial review of a discretionary trust, again, one most worry whether a Wyoming Court will adopt the new view of trust law espoused by the Restatement (Third) of Trusts, which primarily focuses on a reasonableness judicial review standard. If so, a court could easily substitute its view of reasonableness, thus giving beneficiaries enforceable rights and allowing them to compel distributions where none were intended by the settlor, which would frequently defeat the purpose of having a discretionary trust. We would suggest that Wyoming adopt the most common discretionary judicial review standard that a judge may only review for (1) improper motive; (2) failure to use a trustee's judgment; or (3) dishonesty similar to to South Dakota in SB 98.[17]

Distributions to One Current Beneficiary?

The problems created when a beneficiary has an enforceable right to a distribution in a discretionary trust are not limited to estranged spouses. The potentially conflicting interests of beneficiaries could also impede a trustee's discretion.

With most DAPTs and third-party beneficiary-controlled trusts, the DAPT settlor or the primary beneficiary of a beneficiary-controlled trust hopes that, if there is an emergency, the trustee may distribute most, if not all of the assets to the settlor or to the primary beneficiary. However, if all discretionary beneficiaries have an enforceable right to a distribution (i.e., the Restatement (Third) position and most likely the UTC position), can the trustee, without incurring any liability to the other beneficiaries, distribute, most or all of the assets to the settlor or a primary beneficiary? Absent specific language in the trust document allowing this, the likely answer appears to be "no." Hence, the prospect of enforceable property rights in other "bit player" beneficiaries could cause a trustee to

withhold distributions just when it should be making a big distribution to the "primary" beneficiaries.

The Trial Attorney Fear that Rocked Wyoming

Wyoming's statute requires every DAPT settlor to sign an affidavit representing that the settlor has or will maintain "personal liability insurance" in the amount of $1,000,000 or the fair market value of assets placed into the DAPT, whichever is less.[18]

How did this requirement come about? When the trial lawyers found out about the proposed DAPT statute, they persuaded a senator to propose an amendment to the Wyoming UTC to add a tort creditor exception for all trusts. The amendment passed through committee, and if a deal had not been reached with the trial attorneys there was a chance that Wyoming would have had a rather useless DAPT law, as it would not have protected against the onslaught of plaintiffs' litigation that is the very raison d'être of all APT statues.[19] Worse yet, the same provision would have applied to all third party trusts. Fortunately, a compromise was reached with the trial attorneys and resulted in the affidavit requirement.

Interestingly, the official legislative summary to Wyoming's DAPT statute indicates that somebody (at the very least, the summary's author) thought that maintaining insurance was a requirement for obtaining DAPT protections. However, that's not what the actual statute says. The only insurance requirement is the one noted above, i.e., the affidavit must contain the statutorily required representation. So, while the affidavit is required, maintaining insurance is not.

That's not necessarily the end of the story. If a settlor fails to maintain insurance after attesting that he would, then his failure might support an inference of fraudulent intent, especially if the failure was intentional rather than inadvertent and/or occurred soon after the affidavit was executed. That, though, is very different from saying that the DAPT protections are automatically voided.

And, as to the type of insurance, all the statute says is "personal liability insurance." That's obviously open to at least some degree of judicial interpretation. However, "personal" liability insurance is a much broader category than "professional" liability insurance, "directors' and officers'" insurance, "malpractice" insurance, or "E&O" insurance. All of the latter are merely a sub-set of "personal" liability insurance. So, too, is a plain vanilla umbrella policy, which is very cheap and which clients should maintain in any event. So, if an affidavit's insurance representation can be satisfied with a simple umbrella, then this is a de minimis burden on Wyoming DAPT settlors.

Conclusion:

Wyoming should be commended as one of the few UTC states that is squarely addressing many issues, including some of the asset protection issues, created by the UTC. With esteemed estate planners like Doug McLaughlin at the helm, Wyoming is clearly trying to make itself top-flight place for trusts. As indicated above, several key UTC-related issues need further work and a couple of qualified disposition issues may be improved, but Wyoming's "100 plus" substantive amendments and anticipated future amendments in 2009 are a noble start to Wyoming's bid to join the ranks of America's best trust jurisdictions.

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[1] In a letter dated February 20, 2006 to Mark Merric, Doug McLaughlin also notes that it would be easier to start from scratch or copy parts of the Iowa Trust Code than attempting to make so many substantive amendments to the UTC.

[2] For a detailed discussion of these issues, please see *Domestic APT Statutes Outline*, Idaho Bar Association 2006.

[3] Merric & Oshins, *The Effect of the UTC on Spendthrift Trusts*, Estate Planning Magazine, August, September, and October of 2004. This article may be downloaded at www.InternationalCounselor.com. Please note that in response to this article as well as many other authors expressing concerns with the asset protection issues in the UTC, in 2004 and 2005 NCCUSL made many changes to Article 5 and Section 814(a). Douglas McLaughlin has noted that in his view the NCCUSL changes amount to nothing more than "window dressing." Richard Covey and Dan Hastings have noted that the changes under Section 814(a) were not helpful and provided only more confusion. We would agree that the NCCUSL attempted fixes fall substantially short of fixing the asset protection deficiencies in the UTC.

[4] South Dakota actually has two DAPT statutes. The qualified disposition statute as well as the newly enacted discretionary-support trust statute SB 98 that applies to all trusts. SB 98 provides spendthrift protection for all mandatory interests – including a self-settled trust.

[5] Wyoming UTC § 4-10-508, Overdue Mandatory Distributions provides that a creditor cannot reach a mandatory distribution until it is received by the beneficiary. This is the approach that South Dakota took with SB 98. Both Wyoming and South Dakota in general follow the Restatement (Second) of Trusts view. The UTC § 506 and Restatement (Third) take the opposite approach give creditors far broader rights to reach a mandatory distribution.

[6] Alaska AS 34.40.110(b)(3). The full amount of a GRAT or Unitrust interest is protected for a settlor/beneficiary, but other amounts are not.

[7] 12 Del. Code § 3570(11)(5) & (6) – Other than the up to 5% GRAT and 5% Unitrust Interests, mandatory interests are not protected for a settlor/beneficiary under the Delaware Statute.

[8] See note 4.

[9] See note 5.

[10] 11 U.S.C. § 548(e)(1).

[11] See *In Re Baker*, 273 B.R. 892, 896 (Wyo. 2002) (applying Wyoming UFCA, which has since been superceded by Wyoming's UFTA).

[12] Wyoming UTC § 4-10-522 (stating that a trustee "may" resign).

[13] See, e.g., Wyoming UTC §§ 4-10-517 and 4-10-518.

[14] *First National Bank and Trust Company of Wyoming*, 416 P.2d 224 (Wyo. 1966) may be the only authority dealing with a discretionary distribution standard under Wyoming law. Here the issue was the rights between the current discretionary beneficiary and the remainder beneficiary as contrasted with the beneficiary's rights to force a distribution.

[15] See, e.g., *Bass v. Denney (In re Bass)*, 171 F.3d 1016, 1028 (5th Cir. 1998) ("A universal canon of Anglo-American trust law proclaims that when the trustee's powers of distribution are wholly discretionary, the beneficiary has no ownership interest in the trust or its assets until the trustee exercises discretion by electing to make a distribution to the beneficiary"); *U.S. v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994) (similar); *id.*, 507 (Because discretionary trusts give the trustee complete discretion to distribute all, some, or none of the trust assets, the beneficiary has a mere expectancy in the nondistributed income and principal until the trustee elects to make a payment," and therefore "[c]reditors, who stand in the shoes of the beneficiary, have no remedy against the trustee until the trustee distributes the property") (internal cites, quotes omitted).

[16] Missouri St. § 456.5-504. 1.(2).

[17] See Footnote 4.

[18] Wyoming UTC § 4-10-523(a)(ix).

[19] As an interesting sidebar, it appears that only Georgia allows for a tort creditor exception by statute. This is why most estate planning attorneys in Georgia draft discretionary trusts instead of support trusts.