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ASSET PROTECTION PLANNING

(Excerpts of article regarding Delaware Asset Protection Trusts)

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INTRODUCTION

We live in a litigious society. The newspapers are filled with stories of large jury awards. Stories from the McDonald's scalding coffee spill to Philadelphia jury awards against pediatricians in excess of 100 million dollars create uncertainty in the judicial process and the threat of substantial loss of assets creating tremendous anxiety among those with assets to lose.

A. Most recently, a local lawsuit against a noted Delaware physician resulted in a jury award of $7.1 million for alleged negligence. Without getting into the merits of the award, the question must be asked: How can a person economically survive a damage award of that magnitude?

B. It is important to draw distinction between jury awards for negligence, malpractice and the like, and contract liability. Most economically responsible individuals are perfectly willing to suffer the consequences of their own bad business judgments. Houses are purchased subject to a mortgage that the mortgagor fully expects to pay. Lines of credit are extended by banks to individuals who start businesses. Securities investors often margin their stocks. In each of the foregoing situations, the liability is quantifiable. It is the great uncertainty of the unlimited jury award that stifles American businesses and economically responsible American citizens.

C. Efforts have been underway to cap jury awards for some years. Malpractice award limitations have been proposed (but not passed) in Delaware. Proposals to change the American rule, which allows contingent fee awards and requires each party to pay its own legal fees, to the British system where the loser pays, have also failed. With the foregoing in mind, the question must be asked: What prudent steps may be taken to protect assets from runaway jury awards?

D. As you will see, asset protection takes many forms. There is no one answer for all individuals. Decisions must be made on a case by case basis depending upon the assets owned by the individual and the individual's lifestyle and economic goals.

E. The goal is to manage and preserve wealth in a manner that will protect it from the threats of a lawsuit. The case study and legal analysis that follow will illustrate this point. The primary focus of this paper is on preserving assets during lifetime through proper asset protection planning.

THE DELAWARE ASSET PROTECTION TRUST

A. Delaware has always had a strong asset protection statute that protects the beneficiaries of a third party "spendthrift" trust. For example, when due to a parent's death or lifetime creation of an irrevocable trust assets pass to a child in the form of a trust that is properly drafted, the judgment creditors of the child may not reach the assets of the trust to satisfy their lien. 12 Del. C. § 3536. A child may continue to receive lifetime benefits from the trust and may ignore the judgment creditors.

B. Common law and strong public policy prohibited a person from creating a trust for himself ("self-settled trust") to insulate his assets from creditors. It was, therefore, not possible for a person to transfer his or her own assets to a trust that provided lifetime benefits to the person and also protects the assets.

C. All of the traditional thinking on self-settled trusts was changed in Delaware when Delaware adopted The Qualified Dispositions in Trust Act. 12 Del. C. § 3570. The Act was adopted on July 9, 1997. It is now possible for a person anywhere in the United States to establish a Delaware asset protection trust that provides lifetime benefits to that person and also insulates those assets from attachment by judgment creditors notwithstanding that the person continues to receive lifetime benefits from the trust.

D. To create a Delaware asset protection trust the following must occur:

(1) A trust document must be executed.

(2) The trustee must be either a Delaware resident individual or a Delaware trust company.

(3) A Delaware trustee must conduct some minimal level of business, i.e., maintain records, file tax returns, and hold title to the assets.

(4) The trust must be irrevocable.

(5) The trustor may retain the right to veto trust distributions, to receive income, to receive annuity or unitrust payments, to receive principal distributions and appoint the assets at death to the beneficiaries the trustor desires.

(6) A person other than the trustor may be appointed as a distribution advisor for distributions to be made from the trust and an investment direction advisor may also be appointed to direct how the trust assets will be invested.

E. Assets transferred to a Delaware asset protection trust through a qualified disposition that meets the requirements of the statute are protected from claims of judgment creditors against the maker of the trust as follows:

(1) The trust assets are exempt from all claims against the trustor that arise more than four years after the transfer of assets to the trust; and

(2) The trust assets are exempt from all claims that arose before the transfer to the trust one year after actual notice to the claimant of the transfer to the trust.