Court Finds Fraudulent Transfer to Alaska Asset Protection Trust

A federal bankruptcy court rightly set aside as fraudulent a transfer to an Alaska domestic asset protection trust—but did so by applying the wrong reasoning.

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Battley v. Mortensen,[1] decided on 5/26/2011, is the first Alaska domestic asset protection trust (DAPT)[2] case to be decided in federal bankruptcy court. Also, this case is one of the initial bankruptcy court decisions to construe and apply new subsection 548(e), which was enacted as part of the 2005 Bankruptcy Code amendments. The decision set aside as a fraudulent transfer Mortensen's conveyance of a parcel of Alaska property to an Alaska DAPT. Accepting the judge's findings as the trier-of-fact, the decision can be justified as a transfer with an actual intent to hinder, delay, and defraud existing creditors. However, the court's opinion contains a serious misunderstanding of the effect of the 2005 Bankruptcy Code amendments.[3] The court uses this misunderstanding to justify the court's conclusion that language in a trust instrument, which states that a purpose of the trust is to protect assets from potential future creditors, is a "badge of fraud." This conclusion ignores the reality of modern financial, business, and estate planning.

Facts of the case

Thomas Mortensen was a self-employed project manager for the environmental aspects of construction projects. He and his wife had acquired a parcel of land on MacDonald Spit, a very scenic and now trendy recreational area near Seldovia and across from Homer, Alaska. In 1998, Mortensen and his wife divorced, and Mortensen was awarded the Seldovia property. Between 2001 to 2005, Mortensen built several structures on the property. However, Mortensen struggled financially. In 2001 through 2004, he averaged approximately $11,500 net income per year. In June 2004, Mortensen filed a motion with the family court to impose child support against his ex-wife. In response to his wife's opposition, Mortensen stated, in part, that he was "saddled with debt and with increasing competition in my shrinking business market, I have not recovered from the financial carnage of the divorce."

The trust. Mortensen had heard about Alaska's asset protection trust law. He researched the topic and copied a trust form from the Alaska Trust Company's web site. Mortensen filled in the relevant information and then took his completed trust document to a local estate planning attorney for review. The attorney suggested some minor changes and said that otherwise the trust instrument was satisfactory.

The trust beneficiaries were Mortensen, his three children, and further descendants. The trustees were his brother and a personal friend. His mother was named as trust protector and had the power

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to remove and appoint successor trustees. The trust contained a typical perpetual trust dispositive plan. The trust was structured so that transfers to it would be incomplete gifts for federal gift tax purposes.

On 2/1/2005, Mortensen quitclaimed the Seldovia property to the trust. The trust instrument provided that "the [Seldovia property] is considered by the Grantor and the Grantor's children to be a special family place that should not be sold. It should remain in the family."

Mortensen registered the trust and completed an affidavit of solvency, both of which are required by Alaska law. At the time of the transfer of the property to the trust, Mortensen had credit card debt of approximately $85,000, which was owed to six credit card companies. He was not in default on the interest payments to the companies.

Trust language. The "whereas" clauses in the introduction of the trust instrument stated, in part, that the grantor had the "intention of generally obtaining the objectives of benefitting the beneficiaries of the trust while attempting to minimize the extent to which the trust estate is subject to the claims of creditors ...," and "in order to maximize the protection of the trust estate or estates from creditors claims of the grantor or any beneficiary ...." Article Sixteenth of the trust instrument, entitled "Grantor's Intention," provided, "It is the Grantor's intention that the assets held hereunder shall not be subject to the claims of the creditors of either the Grantor or any other beneficiary hereunder."

Financial situation. The property had a fair market value of approximately $60,000 when it was transferred to the trust. Mortensen's mother supported the concept of transferring the property to the trust and sent him $100,000 as payment for the transfer, stating that she wanted to preserve the property for her grandchildren.

The trustee argued that Mortensen deliberately waited for Alaska's four-year statute of limitations to run and then two months later filed for bankruptcy.

From 2005 through 2009, Mortensen's financial situation deteriorated. He lost the $100,000 in commodities investments. He decided to use one of the structures on the Seldovia property as his principal residence. In 2009, he became ill, had surgery, and faced a long period of recovery. In early 2009, Mortensen's credit card debt had grown to $250,000. He had other creditors, primarily health providers relating to his illness, to which he owed approximately $10,000.

On 4/18/2009, four years and two months after transferring the Seldovia property to the trust, Mortensen filed for bankruptcy. As with the formation of the trust, Mortensen represented himself. The bankruptcy trustee, however, quickly brought an adversarial proceeding to set aside the transfer of the Seldovia property as a fraudulent transfer. For the first time, Mortensen then hired an attorney to represent his position.

Parties' contentions

Mortensen argued that the transfer of the property to the trust was not fraudulent. He pointed out that this was a very scenic desirable recreational property enjoyed by his entire family. He wanted to protect this property for his descendants as long as possible. He stated that he was not insolvent when he transferred the property to the trust, and he emphasized that he was not in default on credit card payments. He argued that it was only later that his financial situation deteriorated, especially when he became ill.

The bankruptcy trustee was not persuaded. He argued that Mortensen was struggling financially from 2001 forward. He emphasized that Mortensen had admitted this in his continuing divorce action. The trustee argued that Mortensen intended to defraud the credit card companies from the beginning. The trustee pointed out that immediately after Mortensen formed the trust in 2005, he engaged in a frenzy of credit card activity. From 2005 to 2009, Mortensen ran up credit card debt from $85,000 to $250,000. The trustee argued that Mortensen deliberately waited for Alaska's four-year statute of limitations to run and then two months later filed for bankruptcy. The trustee argued that fraudulent intent was clear from the trust language, which stated that his intent was to maximize the protection of the trust estate from creditors' claims.

Bankruptcy Court's decision

The court first held that the ten-year limitations period of Bankruptcy Code section 548(e) applied. Therefore, the trustee's fraudulent transfer claim was not barred by Alaska's four-year limitations period. The court then focused on the issue of whether Mortensen transferred the Seldovia property

[1] 2011 WL 5025288 (Bkrptcy. DC Alaska, 2011).

[2] Domestic asset protection trust is a synonym for a self-settled discretionary spendthrift trust.

[3] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

to the trust "with actual intent to hinder, delay, or defraud" his creditors. The bankruptcy judge analyzed Mortensen's financial status as of the date of the transfer to the trust. The court concluded that Mortensen was solvent when he created the trust. The court also noted that the trust was created in accordance with Alaska law.

The court then examined section 548(e), which was added to the Bankruptcy Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act. This subsection provides, in relevant part:

> (e)(l) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—
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> (A) such transfer was made to a self-settled trust or similar device;
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> (B) such transfer was by the debtor;
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> (C) the debtor is a beneficiary of such trust or similar device; and
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> (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.[4]

The court concluded that the trust language, which indicates an intent to protect assets from creditors, is a badge of fraud. The relevant portion of the court's decision is as follows:

> Mortensen argues that the trust language cannot be used to determine intent because Alaska law expressly prohibits it. Under Alaska law, "a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud."[48] [fn 48: AS 34.40.110(b)(1).] But is this state statutory provision determinative when applying § 548(e)(l)(D) of the Bankruptcy Code?
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> Ordinarily, it is state law, rather than the Bankruptcy Code, which creates and defines a debtor's interest in property.[49] [fn 49: *Butner v. United* States, 440 U.S. 48, 55 (1979).]
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> Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.[50] [fn 50: *Id.*]
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> Here, Congress has codified a federal interest which requires a different result. Only five states allow their citizens to establish self-settled trusts.[51] [fn: 51: In addition to Alaska, Delaware, Nevada, Rhode Island and Utah permit the creation of self-settled trusts.] Section 548(e) was enacted to close this "self-settled trust loophole."[52] [fn 52: 5 COLLIER ON BANKRUPTCY ¶ 548.10[1], citing H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 449 (2005) (statement of Rep. Cannon).] As noted by Collier:
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> [T]he addition of section 548(e) is a reaction to state legislation overturning the common law rule that self-settled spendthrift trusts may be reached by creditors (and thus also by the bankruptcy trustee.)[53] [fn 53: 5 COLLIER ON BANKRUPTCY ¶ 548.10[3][a] (footnotes omitted).]
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> It would be a very odd result for a court interpreting a federal statute aimed at closing a loophole to apply the state law that permits it. *I conclude that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud.* In this bankruptcy proceeding, AS 34.40.110(b)(l) cannot compel a different conclusion.
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> To establish an avoidable transfer under § 548(e), the trustee must show that the debtor made the transfer with the actual intent to hinder, delay and defraud present or future creditors by a preponderance of the evidence.[54] [fn 54: *Consolidated Partners Inv. Co. v. Lake*, 152 B.R. 485, 488 (Bankr. N.D. Ohio 1993).] *Here, the trust's express purpose was to hinder, delay and defraud present and future creditors.* [Emphasis added.]

The nontrust evidence

The court's reliance on an intent to protect against "future" creditors as a badge of fraud is troubling. The court's reasoning is analyzed, in depth, below. However, first it is important to emphasize that the court did not rely on this language alone to resolve this case. Rather, the court stated, "[h]owever, there is additional evidence which demonstrates that Mortensen's transfer of the Seldovia property to the trust was made with the intent to hinder, delay and defraud present and future creditors." The court pointed out that Mortensen's earnings averaged just $11,644 per year during the four years prior to creating the trust. He had accumulated credit card debt of approximately $85,000, and he stated that he was experiencing "financial carnage" from his divorce. His estimated overhead was $5,000 per month.

The court concluded that Mortensen was "well under water" when he sought to put the Seldovia property out of the reach of his creditors by placing it in the trust." The court noted that Mortensen had placed $80,000 of the $100,000 his mother paid him into the trust and had lost all of the funds by speculating in the stock market. Mortensen had claimed that he had paid off his credit card debts periodically and then reborrowed against them. The court stated, "I can find no evidence of such payoffs in the documentary evidence and I don't believe Mortensen. Nor do I believe that the trust repaid Mortensen the $80,000 in 2006." Furthermore, "I conclude that Mortensen's transfer of the Seldovia property and the placement of $80,000 into the trust constitutes persuasive evidence of an intent to hinder, delay and defraud present and future creditors."

The court also stated that Mortensen had alleged that the purpose of the trust was to preserve the Seldovia property for his children, yet he used the trust to make stock market investments, and the

4 11 U.S.C. section 548(e)(l).

trust also made a car loan to one of Mortensen's friends. The court emphasized that "these activities had no relationship to the trust's alleged purpose." The court concluded, "[t]he bottom line for Mr. Mortensen is that he attempted a clever but fundamentally flawed scheme to avoid exposure to his creditors." The court went on to state, "Mortensen will now pay the price for his actions."

Intent to hinder, delay, or defraud

As the above description of the court's decision establishes, the bankruptcy judge found plenty of evidence to support a finding of a transfer with an actual intent to defraud existing creditors. Mortensen's tenuous financial situation, his existing credit card debt, the run-up of this credit card debt to the same and other credit card companies over the next four years, his use of the trust for purposes other than the protection of its assets, and the court's finding of lack of credibility were enough to support the fraudulent transfer conclusion. Once the court made its findings as the trier-of-fact, this decision was probably the right result.

In a motion for reconsideration, Mortensen's attorney argued that Mortensen's mother should really be considered the grantor of the Mortensen Seldovia Trust because she paid Mortensen $100,000 in exchange for the transfer to the trust. The court rejected this contention because "this is simply not what occurred." Mortensen's attorney also argued that a transfer of the residence to the trust is not evidence of an actual intent to defraud creditors because the property was exempt from creditors under Alaska's homestead provision because Mortensen used it as his principal residence. Alaska Statute 09.38.010 protects residences from creditors, up to a value of $67,500. The court responded that there was no clear-cut evidence that this residence was more than a part-time or vacation home.

Erroneous legal analysis

The legal analysis used by the court in reaching the holding includes some troubling points.

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Asset protection planning. The court was wrong in its legal analysis and conclusion that trust language indicating an intent to protect against "future" creditors is a badge of fraud. Such a conclusion fails to recognize that asset protection planning has become a cornerstone of financial, business, and estate planning. It began decades ago when corporations and limited partnerships were formed with a primary purpose to protect against creditors' claims. More recently, limited liability companies serve the same purpose. Irrevocable trusts, with spendthrift provisions, have a primary purpose of protecting assets from future creditors' claims. Since 1997, Alaska and ten other states have enacted laws expressly providing that a self-settled spendthrift trust protects assets from creditor claims. Those states are:

1. Delaware.
2. Hawaii.
3. Nevada.
4. New Hampshire.
5. Oklahoma.
6. Rhode Island.
7. South Dakota.
8. Tennessee.
9. Utah.
10. Wyoming.

In addition, Missouri already had such a statute, and some commentators argue that Colorado's statute provides such protection.[5]

Bankruptcy Code section 541(c)(2) expressly excludes spendthrift trusts from the property included in a bankrupt's estate. Further, as the court noted, Alaska statutes expressly provide that "a settlor's expressed intention or motive to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud."[6]

The Townley *case.* What then led the bankruptcy trustee to argue, and this court to conclude, that language indicating an intent to protect assets from future creditors was a badge of fraud? To fully understand this argument, it is important to review the case of *Townley*.[7] The Townleys were tax protestors who ran a home for troubled boys in the state of Washington. The federal government brought an action in federal district court in order to foreclose a federal tax lien. The government wanted to reach assets that the Townleys had placed in an irrevocable trust. The district court in its opinion stated:

> Specifically, Mr. Townley stated in his deposition that he was concerned about potential "lawsuits from the exposure we had from liability from troubled boys in the State of Washington." (Ct. Rec. 58, Ex. 1). Additionally, Mr. Townley stated that it was his goal to protect his assets from anyone who might get a judgment against him. *Id.* at 18, 20. He also stated that he did not transfer the property with the intent to avoid any tax liabilities. *Id.* at 25. Plaintiff asserts that Mr. Townley's statements that he intended to protect his assets from anyone who might get a judgment against him

[5] See note 25, *infra*.

[6] Alaska Statute 34.40.110(b)(1).

[7] U.S. Dist. Ct. E.D. Wash., No. CV-02-00384-RHW (2004).

> is conclusive, direct evidence of intent to hinder, delay, or defraud. The Court agrees.
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> * * *
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> Mr. Townley's statement that he wanted to protect his assets from any potential "lawsuits from the exposure we had from liability from troubled boys in the State of Washington" represents direct evidence of his intent to defraud one of his potential future creditors, which is prohibited by § 19.40.041(a) [Washington state's Uniform Fraudulent Transfer Act].
>
> 2. Badges of Fraud
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> Even if Mr. Townley's statements do not support a finding of direct evidence of intent, Plaintiff meets the requirements of § 19.40.041(b) by showing overwhelming circumstantial evidence that Defendants intended to defraud the IRS by transferring the title of their properties to Beaver Valley Trust.

The district court then pointed out that the Townleys had retained possession and control of the trust property, had transferred the property in anticipation of a lawsuit, and had transferred substantially all of their assets to the trust. The Ninth Circuit, in an unpublished 2006 memorandum opinion, affirmed the Townley decision, stating in part:

> The Townleys' repeated admissions that they transferred property to the Trust in order to avoid potential future creditors provide direct evidence of fraud. Further, by demonstrating that the property transfer was characterized by multiple badges of fraud, the government also showed compelling circumstantial evidence of fraud.[8]

The Alaska legislature in 2008 reacted to the Townley decision. The legislature amended Alaska's spendthrift trust statute to add "a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud ...."[9]

With the above background in mind, it is time to return to the *Mortensen* situation. The bankruptcy trustee, perhaps thinking of *Townley*, argued that the trust's language stating an intent to protect assets from creditors' claims established an actual intent to hinder, delay, or defraud Mortensen's creditors. Mortensen's bankruptcy attorney countered that the Alaska statute, quoted above, prohibited the bankruptcy trustee from arguing that the trust language establishes an intent to defraud.

Faced with this state law, the court first noted that ordinarily state law determines the debtor's interest in property, unless a federal interest requires a different result. The court's starting point, in its analysis, appears flawed. The issue of whether a transfer is fraudulent does not involve a property right.[10] Therefore, the bankruptcy court did not need to find an exception to the principle that ordinarily it is state law, rather than the Bankruptcy Code, that creates and defines a debtor's interest in property. Rather, the bankruptcy court could have ignored the Alaska statute on the premise that federal bankruptcy law, not state law, determines whether a transfer is fraudulent in the federal bankruptcy setting. The court also erroneously stated that only five states allow self-settled trusts. In fact, as discussed above, at least 12 states permit this.

The most important part of the court's reasoning, however, is its conclusion that Congress, in enacting section 548(e), has established a federal principle that justifies the court not only to ignore state law but also to conclude that the trust's express language established an intent to hinder, delay, and defraud present and future creditors. In reaching this conclusion, the court cites the treatise *Collier on Bankruptcy* for the proposition that section 548(e) "closes the self-settled trust loophole" based on the legislative history.

Legislative history

The legislative history, however, is directly counter to the court's interpretation of Bankruptcy Code section 548(e). In 2005, during the debate on the Bankruptcy Code amendments in the Senate, the *New York Times* published an article describing the "millionaire's loophole" created by domestic asset protection trusts.[11] The article pointed out that the "Senate bill is favored by banks, credit card companies, and retailers, who say that it is now too easy for consumers to erase their debts through bankruptcy."

The article presented the views of two law professors who described DAPTs and stated, "the millionaire's loophole that is the result of these trusts needs to be closed."[12] Further, "this is just a way for rich folks to be able to slip through the noose on bankruptcy, and, of course, the double irony here is that the proponents of this bill keep pressing it as designed to eliminate abuse ...."[13] The *Times* article stated that, "asset protection trusts have become increasingly popular in recent years among physicians, who fear large medical malpractice

[8] 181 Fed. Appx. 630, 97 AFTR2d 2006-2484 (CA-9, 2006).

[9] Alaska Statute 34.40.110(b)(1).

[10] See, e.g., Craft, 535 U.S. 274, 89 AFTR2d 2002-2005 (2002).

[11] Morgenson, "Proposed Law on Bankruptcy Has Loophole," NY Times, 3/2/2005.

[12] *Id.*, quoting Elena Marty-Nelson, Nova Southeastern University.

[13] *Id.*, quoting Elizabeth Warren, Harvard Law School.

awards, and corporate executives, whose assets are at greater peril now because of new laws."

In response to the *New York Times* article, Senator Schumer (D-NY) introduced an amendment that would have allowed a bankruptcy trustee to set aside transfers in excess of $125,000, cumulatively, to a DAPT within ten years of the filing of a bankruptcy.[14] This amendment was defeated by a vote of 56 to 39.[15]

Senator Talent (R-MO) responded with a compromise approach,[16] which is the language ultimately enacted as 11 U.S.C. section 548(e). Senator Talent's discussion on the floor of the Senate emphasized the need to prevent "dishonest people," "crooks," and "criminals" from protecting their assets by transferring them to DAPTs.[17] His discussion focused especially on corporate criminals involved in corporate fraud. He concluded by stating, "I urge my colleagues to support this amendment—it simply cracks down on criminals." This amendment passed the Senate by 73 to 26.

The enacted amendment requires the showing of "actual intent to hinder, delay, or defraud" before the bankruptcy trustee could avoid a transfer to a DAPT. Senator Schumer vigorously protested the "actual intent" requirement, stating "I do not have to tell anyone here who is a lawyer that to prove that intent, especially when the filer would want to make sure that intent could not be proven and would leave no paper trail, no documents or anything else, would be next to impossible."[18]

When Senate Bill 256 was considered in the House Judiciary Committee, Representative Delahunt (D-MA) submitted an amendment that would limit the amount of DAPT assets protected from creditors to $125,000.[19] Representative Cannon (R-UT) responded by arguing that fraudulent transfers made to DAPTs may be avoided both under state law as well as under Senator Talent's amendment, which allows transfers to DAPTs to be set aside if made with actual intent to hinder, delay, or defraud a creditor, and concluded that this is adequate to eliminate the "millionaire's loophole." Representative Cannon emphasized that, "[t]he states should be able to determine for themselves what property their citizens can protect from the claims of creditors." Representative Delahunt's amendment was defeated by a vote of 15 to 10. Senate Bill 256, which included Senator Talent's amendment, passed the House on 4/14/2005, by a vote of 302 to 126.[20]

DAPTs are commonly used in estate planning not only for asset protection purposes but also for a variety of tax and nontax planning purposes, including transfer tax minimization, state tax planning, and prenuptial planning.[21] The legitimate use of DAPTs for asset protection planning is to set aside a "nest egg" at a time when the settlor either does not have existing liabilities or such liabilities are covered by other assets. The amendments proposed by Senator Schumer and Representative Delahunt would have had the practical effect of eliminating the effectiveness of DAPTs for these purposes. Therefore, this Bankruptcy Act debate placed squarely before Congress the question of whether DAPTs, formed without fraudulent transfers, should be allowed. Congress decided affirmatively, by a wide margin.

The key operative language of the DAPT amendment (11 U.S.C. section 548(e)) to the 2005 Bankruptcy Act is identical to the existing fraudulent transfer language of Bankruptcy Code section 548(a)(1)(A), with the two-year limitations period extended to ten years. Similarly, the operative language—"actual intent to hinder, delay or defraud"—is iden-

14 Amendment No. 42, introduced 3/3/2005; 151 Cong. Rec. S1980.

15 151 Cong. Rec. S1994 (3/3/2005).

16 Senate Amendment 121, 151 Cong. Rec. S2137 (3/7/2005).

17 151 Cong. Rec. S2427 (3/10/2005).

18 *Id.*

19 H. Rep't 109-031, Part I.

20 151 Cong. Rec. H2076 (4/14/2005).

21 These purposes are thoroughly discussed in Shaftel and Bundy, "Domestic Asset Protection Trusts Created by Nonresident Settlors," 32 ETPL 17 (April 2005).

22 UFTA section 4(a)(1).

23 "Legislative Fact Sheet." www.nccusl.org.

24 *Id.* Alaska has limited its fraudulent transfer statute to only "fraud" and has severely restricted the discovery exception.

25 Alaska Stat. § 34.40.110(b)(1); Del. Code tit. 12, §§ 3572(a) and (b); Hawaii Permitted Transfers in Trust Act, § 5; Mo. Rev. Stat. § 456.5-505.3(1); Nev. Rev. Stat. § 166.170; N.H. Rev. Stat. Ann. § 564-D:9; Okla. Stat. tit. 31, § 17; R.I. Gen. Laws § 18-9.2-4(a) and § 6-16; S.D. Codified Laws § 55-16-9; Tenn. Code Ann. § 35-16-104(a); Utah Code Ann. § 25-6-14(1)(c)(ii); and Wyo. Stat. Ann § 4-10-514.

26 The discussion in both the Senate and House, and the need for the enactment of the above-quoted amendment, support the conclusion that DAPTs are included within the protection provided by Bankruptcy Code section 541(c)(2), which excludes the assets of spendthrift trusts from the bankruptcy estate. This had been an open issue, which the 2005 amendments resolved in favor of DAPTs. Whether DAPTs were so included in the protection of section 541(c)(2) was discussed in Eason, "Developing the Asset Protection Dynamic: A Legacy of Federal Concern," 31 Hofstra L. Rev. 23 (Fall 2002); and Sjuggerude, "Defeating the Self-Settled Spendthrift Trust in Bankruptcy," 28 Fla. St. U. L. Rev. 977 (Summer 2001).

27 H. Rep't 109-031, Part I.

28 See, Spero, Asset Protection: Legal Planning, Strategies and Forms (Thomson Reuters/WG&L 2011, updated quarterly), ¶ 3.03[4][a].

29 Readers interested in a discussion of the use of DAPTs by both residents and nonresidents of DAPT states, and how they may fare in both state and federal courts, may refer to the following articles: Shaftel, "IRS Letter Ruling Approves Estate Tax Planning Using Domestic Asset Protection Trusts," 112 J. Tax'n 213 (April 2010); Shaftel and Bundy, "Domestic Asset Protection Trusts Created by Nonresident Settlors," 32 ETPL 17 (April 2005); Shaftel and Bundy, "Domestic Asset Protection Trusts and the Bankruptcy Challenge," 32 ETPL 14 (May 2005); Shaftel and Bundy, "Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts," 32 ETPL 28 (July 2005); Spero, Asset Protection: Legal Planning, Strategies and Forms (Thomson Reuters/WG&L 2011, updated quarterly), ¶ 6.08[5].

tical to the language used in the Uniform Fraudulent Transfer Act ("UFTA"),[22] which has been enacted in 44 states.[23]

The UFTA has a four-year statute of limitations but contains a one-year discovery exception to that limitations period. Thus, if a creditor reasonably discovers a transfer to a DAPT after the four-year limitations period has expired, the creditor has an additional year within which to file an action and argue that the transfer to the DAPT was made with the intent to hinder, delay, or defraud the creditor.

All the DAPT states, except Alaska, have enacted UFTA.[24] Further, all the DAPT state statutes provide that fraudulent transfers to a DAPT are not given spendthrift protection.[25] As a result, if the 2005 Bankruptcy Code amendment is construed and applied similarly to Bankruptcy Code section 548(a)(1)(A) and UFTA, then the enactment of this provision will have added little to the law in this area.[26]

Collier's and the Alaska Bankruptcy Court's reliance on Representative Cannon's statement that section 548(e) closes a "loophole" is misplaced authority for a notion that the section does anything more than merely extend the two-year statute of limitations to ten years. Representative Cannon was from Utah, a DAPT state. He was resisting the proposals that DAPTs be restricted to $125,000. He emphasized that "the states should be able to determine for themselves what property their citizens can protect from the claims of creditors."[27]

The legislative history clearly indicates that while Congress contemplated harsher restrictions, it then expressly rejected them. Bankruptcy Code section 548(e) does not disallow or restrict self-settled trusts; rather, it affirms them. The only change section 548(e) made was to extend the two-year limitations period to ten years. The test remains the same as it existed in the Bankruptcy Code before the 2005 amendments and as it exists under the Uniform Fraudulent Transfer Act adopted by the vast majority of states. The 2005 bankruptcy act amendments, which included Bankruptcy Code section 548(e), do not establish authority for applying any other tests or restrictions than those that already existed in federal and most state laws.

The bankruptcy court could have ignored the Alaska statute on the premise that federal bankruptcy law, not state law, determines whether a transfer is fraudulent in the federal bankruptcy setting.

Conclusion

The bankruptcy trustee in *Battley v. Mortensen* invited clear error when he argued and obtained the court's acceptance of the theory that the trust language was a badge of fraud. The 2005 amendments to the Bankruptcy Code do not support this theory. Unfortunately, the case was settled rather than appealed. Therefore, we will not immediately obtain review of this bankruptcy court's legal reasoning. Again, it is important to emphasize that the court did not need this reasoning or the reliance on the trust language to establish a fraudulent transfer. There was substantial additional evidence supporting the court's decision.

It is also important to recognize that the trust language at issue did not distinguish between existing and "future" creditors. This distinction was made by the court in its opinion when it stated, "I conclude that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud." And again, "Here, the trust's express purpose was to hinder, delay, and defraud present and future creditors." The court's addition of "future" creditors was unnecessary. Many of the credit card company creditors involved in the Mortensen situation existed when the trust was formed and the Seldovia property was transferred to it.

The court's additional focus on future creditors, without clarification, creates a broad area of ambiguity. The general rule is that a transfer made out of caution to protect against possible future creditors is not fraudulent. Most decisions interpret the phrase "future creditor" narrowly to mean known or contemplated creditors.[28]

A settlor's general intention to protect assets from potential future creditors should not be used as a badge of fraud. As discussed above, this is a primary intention of many people who form business entities and irrevocable trusts. Planning to safeguard assets is so common that its neglect may even be malpractice. Statements in a trust instrument or business entity document, discussions with professional advisors, and even direct statements in a deposition with respect to such an intent should not be considered a badge of fraud. Rather, such an intent should be encouraged as sound business, financial, and estate planning. This type of planning and these statements are so common as to add no significance to the analysis of whether a transfer is fraudulent.[29] ■