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Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #332

Date: 24-Oct-16

From: Steve Leimberg's Asset Protection Planning Newsletter

Subject: [Steve Oshins on the Kloiber Case: Delaware Dynasty Trust Broken into Pieces by Beneficiary's Divorcing Spouse](#)

“The file-stamped e-filed [Proposed] Order Severing Trust, dated August 16, 2016, was obtained via facsimile and payment to the Court of Chancery of the State of Delaware and posted at this [Link](#).

The [Proposed] Order refers to a Settlement Agreement entered into by Daniel and Beth in the divorce action which is ‘contingent upon the entry of an order in the Delaware Court of Chancery severing the Dynasty Trust to create a separate trust for the benefit of Beth to be funded with assets of the Dynasty Trust (the Severed Trust);’

Although Delaware trusts bear the negative publicity with a settlement like this, as well as by having the Garretson case on its books, there are many other jurisdictions with spendthrift trusts having the same lack of protection against a divorcing spouse, either by case law saying the spouse is not a creditor or by exception creditor statute or case law. The reason Delaware gets highlighted for its lack of protection against divorcing spouses is that it is widely considered one of the big four Dynasty Trust states, along with Alaska, Nevada and South Dakota. But practitioners should always consider the law of the trust situs whenever divorcing spouses of the beneficiaries are a concern, even when the trust isn’t situated in one of the big four states.”

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Steve authors three different annual state rankings charts and one state income tax chart:

- [The Annual Domestic Asset Protection Trust State Rankings Chart](#)
- [The Annual Dynasty Trust State Rankings Chart](#)
- [The Annual Trust Decanting State Rankings Chart](#)
- [The Annual Non-Grantor Trust State Income Tax Chart](#)

The estate planning community has been discussing the Daniel and Beth Kloiber divorce action for the past few years. A settlement has recently been reached by the parties.

Here is Steve’s commentary:

EXECUTIVE SUMMARY:

The high profile divorce between Kentucky residents Daniel (“Daniel”) and Beth (“Beth”) Kloiber took center stage in 2014 when their Unpublished jurisdictional decision (the “2014 Delaware Court Decision”) was released by the Court of Chancery of Delaware in the [Matter of Daniel Kloiber Dynasty Trust u/a/d December 20, 2002, 2014 WL 3924309 \(Del. Chan., Unpublished, August 6, 2014\)](#).

Daniel's father, Glenn had established a Delaware Dynasty Trust for the benefit of Daniel, Daniel's spouse (defined using a floating spouse definition that she be married to and cohabitating with him to be a beneficiary) and Daniel's descendants. Glenn gifted approximately \$15,000 to the trust in 2002. In 2003, Dan sold 99.45% of his Extreme Software, Inc. shares to the trust for an unsecured promissory note with a face amount of \$6 million.

In June 2007, the trust sold approximately 80% of its Extreme Software, Inc. shares to an unrelated third-party company for approximately \$250 million. In March 2008, the trust sold its remaining stock to a different unrelated third-party company for approximately \$60 million. So there were big numbers involved and Beth understandingly wanted a piece of the trust in the divorce.

The biggest issue for the estate planning community was whether Beth's *Garretson v. Garretson* argument noted in that opinion would allow her to bust through the trust to claim some of the assets via the divorce.

COMMENT:

I co-authored a **LISI** newsletter on the *Garretson* case with Bob Keebler in *Steve Oshins & Bob Keebler on the 40th Anniversary of Garretson v. Garretson: Spendthrift Trusts and Divorce Protection*, **LISI Asset Protection Planning Newsletter #217 (January 10, 2013)** at <http://www.leimbergservices.com>. In that newsletter, we noted that Delaware has had this case on its books since 1973 and that this case holds that a Delaware support trust, such as one with health, education, maintenance and support as the distribution standard, is susceptible to being taken by a divorcing spouse.

Specifically, the Supreme Court of Delaware ruled in the *Garretson* case that Delaware public policy is such that the rights of a divorcing spouse to access the assets of a spendthrift trust override the rights of a settlor to establish a third-party spendthrift trust for the benefit of the settlor's intended beneficiaries and protect those trust assets from the divorcing spouses of the trust beneficiaries.

Needless to say, Delaware trust proponents were not pleased. A response to the 2013 **LISI** article was published in *Jocelyn Borowsky and Jennifer Wallace on In re Garretson*, **LISI Asset Protection Planning Newsletter #221 (February 28, 2013)** at <http://www.leimbergservices.com>. The authors of that article claimed that Delaware support trusts are not susceptible to claims of divorcing spouses in a beneficiary's divorce.

However, since 1973 when the *Garretson* case was decided, there does not appear to be any case law or statutory law overriding the decision in that case.

Delaware's Position on Divorcing Spouses and Spendthrift Provisions

The 2014 Delaware Court Decision specifically noted in part:

Second, the Qualified Dispositions Act limits the rights available to creditors of a Trust. Beth has cited Delaware Supreme Court authority holding that a wife seeking maintenance from her husband is not a creditor. See Garretson v. Garretson, 306 A.2d 737, 740 (Del. 1973).

An action brought by a wife seeking separate maintenance from her husband who has deserted her is an attempt on her part to compel the performance of a duty imposed by law upon the husband to support his wife and dependents.

The weight of authority is to the effect that a wife seeking such relief is not a creditor and is not bound by the spendthrift provisions of a trust from reaching the trust assets.

Id. If she is right, then perhaps the Qualified Dispositions Act would not apply.

Third, the Qualified Dispositions Act itself states that the limitations imposed by Section 3572 on a creditor's ability to reach trust assets do not extend [t]o any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse or children, or for a division or distribution of property incident to a judicial proceeding with respect to a separation or divorce in favor of such transferor's spouse or former spouse, but only to the extent of such debt. 12 Del. C. sec. 3573(1).

[Proposed] Order Severing Trust

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The Delaware Court of Chancery employee with whom I spoke told me that the material items such as the dollar amount of assets transferred into Beth’s Severed Trust were sealed and thus unavailable to the public.

This Isn’t Just a Delaware Problem

Although Delaware trusts bear the negative publicity with a settlement like this, as well as by having the *Garretson* case on its books, there are many other jurisdictions with spendthrift trusts having the same lack of protection against a divorcing spouse, either by case law saying the spouse is not a creditor or by exception creditor statute or case law. The reason Delaware gets highlighted for its lack of protection against divorcing spouses is that it is widely considered one of the big four Dynasty Trust states, along with Alaska, Nevada and South Dakota. But practitioners should always consider the law of the trust situs whenever divorcing spouses of the beneficiaries are a concern, even when the trust isn’t situated in one of the big four states.

Drafting Around the Delaware Problem

Except for the lack of protection from divorcing spouses of the trust beneficiaries, Delaware is otherwise one of the better jurisdictions. However, if you choose to use Delaware law, then you should draft the trust as a discretionary trust rather than a support trust since a discretionary trust doesn’t need to rely on the spendthrift clause to protect the trust assets. A discretionary trust generally uses a bifurcated trustee structure with the primary beneficiary as the investment trustee and a close friend, bank or trust company as the distribution trustee. This is not difficult drafting, and in this author’s opinion it should be the only way to draft a Delaware trust.

But if you prefer to use a trust with health, education, maintenance and support or another support standard for distributions, then very simply you should not use Delaware or any other jurisdiction

that subjects these trusts to divorcing spouses.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Steve Oshins

TECHNICAL EDITOR: DUNCAN OSBORNE

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