Will the Alaska Trusts Work?

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Those contemplating establishing an Alaska asset protection trust based on that state's new statute should first consider the impediments to effective asset protection in Alaska, both those intrinsic to Alaska's statehood and those in the new Alaska law.

When a prospective settlor of an asset protection trust evaluates various jurisdictions to determine the best location for the trust, one consideration is paramount: the level of shelter from creditors' claims. Issues such as physical proximity, cultural comfort, and familiarity with the local legal system become important only after the desired level of protection is reached. Thus, the settlor (or the settlor's advisor) must focus on the legal tools a creditor can use to attack a trust and must determine the corresponding defenses each jurisdiction provides. The most successful asset protection jurisdictions have erected legal barriers that all but eliminate the creditor's arsenal.

Alaska has recently enacted sweeping legislation with a view toward becoming a viable venue for establishing asset protection trusts. However, Alaska faces some major hurdles in its bid to become a major player in the asset protection community. By its very nature, Alaska cannot be as protective a site for establishing trusts as an offshore jurisdiction because Alaska is a part of the United States and is therefore bound by the U.S. Constitution. First, by virtue of the "full faith and credit" mandate in the Constitution,[1] Alaska courts must recognize judgments rendered under the laws of less debtor-friendly states. In addition, the enactment of laws enabling asset protection trusts may itself violate the Constitution's contract clause.[2] Finally, due to the supremacy clause[3] of the Constitution, the Alaska statute cannot protect debtors from conflicting federal law (in this case, bankruptcy law). Even if the legislation passes constitutional muster, however, it does not necessarily protect an asset protection trust from some of the arguments available to a creditor through existing Alaska law.

The new statute, existing statutory provisions, and Alaska common law provide various opportunities for a sympathetic court, whether in Alaska or elsewhere, to set aside or penetrate the trust structure in favor of creditors.

This article will discuss the potential problems with Alaska asset protection trusts, both those intrinsic to Alaska's statehood and those not otherwise resolved by the new legislation. The analysis assumes that an Alaska trust will not have significant assets or administration offshore. Otherwise, the trust would be better characterized as an offshore trust with an Alaskan backdrop, garnering its principal protective features

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from the fact that its assets and trusteeship are not within the United States.

Full Faith and Credit Issues

If a judgment creditor of a settlor of an asset protection trust wants to pursue trust assets in a post-judgment enforcement action, the creditor ultimately must involve a court that has jurisdiction over the trust assets or over a party in control of the trust assets. In the case of a trust created offshore, this post-judgment enforcement action is problematic because the offshore jurisdictions that are favorable asset protection trust venues do not have laws that permit the recognition and enforcement of U.S. judgments. This generally means retrying the original case on the merits and then bringing a post-judgment enforcement action to reach trust assets in the jurisdiction where trust assets or the trustee is located, a task that typically is extremely difficult, if not practically impossible, due to procedural and financial hurdles.

However, in the United States, that task is much more manageable, primarily because of the full faith and credit clause of the U.S. Constitution. Under the right circumstances, the assets of an Alaska trust could be reached by a creditor who never even sets foot in an Alaska court. More likely, however, the assets could be reached by a creditor who appears in an Alaska court on a *pro forma* basis to have the court enforce a judgment rendered by the court of another state. As will be shown, this ability of creditors to sue effectively outside Alaska obviates some of the protection the drafters of Alaska's new statute intended to provide.

Jurisdiction. In order for a judgment creditor of the settlor to enforce a judgment against assets of a trust that the settlor has created and funded, the creditor must proceed in a court that has jurisdiction over some aspect of the trust. If the trust is an Alaska trust, this does not necessarily mean an Alaska court. Another state's court may have jurisdiction over the trustee, the settlor, or the trust assets.

A court could have jurisdiction over the trustee or settlor in a number of ways:

- *Individuals are always subject to the jurisdiction of courts within their domiciles.*[4] Generally, this means that a non-Alaska trustee or settlor is subject to the jurisdiction of his or her home state's courts. Jurisdiction may also exist under the long-arm statute if the trustee or settlor has sufficient contacts with the forum state.[5]
- *Corporations are subject to the jurisdiction of the courts in the state of their incorporation.*[6] They are also subject to the jurisdiction of courts in any state in which they do business.[7] For large corporate trustees such as banks, including those based or with offices in Alaska, this could effectively give jurisdiction to the courts of many states.
- *A state's courts also will have jurisdiction over all property within the state's borders.*[8] This includes real property, bank and brokerage accounts, and shares of stock issued by corporations incorporated in that state.[9] If a trust holds stock in many different corporations, its property may be subject to the jurisdiction of several state's courts. Furthermore, any non-Alaska activities in which the trust participates will likely involve the maintenance of accounts outside Alaska, which would become targets of creditors seeking to pursue their claims outside of the Alaska courts.

The mere fact that a non-Alaska court has jurisdiction to hear a creditor's post-judgment enforcement action does not guarantee a creditor victory. The creditor

must also advance an argument that convinces the court that it should enforce the underlying judgment on the merits against the assets of the judgment debtor's Alaska asset protection trust. A judgment creditor's arguments typically will fall into one or more of the following categories, which might be pled individually or in the alternative: (1) the Alaska trust's asset protection features offend public policy in the state where the post-judgment action is brought and, therefore, the governing law of the trust (Alaska law) should be ignored in favor of the law of such state; (2) the settlor's conveyance to the Alaska trust was a fraudulent conveyance and, therefore, should be set aside; or (3) the Alaska trust is a "sham" trust or is the alter ego of the settlor and, therefore, because the settlor never really parted with dominion and control over the trust assets, the court should disregard the trust structure.

Governing Law. A court that has determined that its jurisdiction is proper must decide whether to apply its own state's law or the governing law of the trust (that is, Alaska law). The general rule for trusts is that courts will apply the governing law of the trust.[10] However, there is an exception to this rule. If the state where a court exercises jurisdiction has a sufficiently strong public policy against a pertinent provision of the governing law of the trust, the court will ignore the governing law provision of the trust agreement and substitute its state's law to resolve the matter before the court.[11]

One of the key provisions of the new Alaska law is that it permits and recognizes the validity of "self-settled" discretionary trusts. In other words, a settlor can set up a trust, the assets of which are not reachable by the settlor's creditors, and still retain an interest in the trust (the ability to receive distributions at the discretion of the trustee). Nearly all other states have either statutory or case law to the effect that self-settled discretionary trusts are void with respect to creditors' claims for public policy reasons.[12] Therefore, all assets of such a trust that are subject to the settlor's ability to receive discretionary distributions are also fully reachable by the settlor's creditors.

Thus, if the non-Alaska court decides that this rule is a sufficiently strong tenet of its state's public policy, the court may decide to ignore the Alaska provisions in favor of its own and declare the trust assets reachable by creditors, thereby eliminating the protection the trust was designed to achieve.

Sham or Alter Ego. The non-Alaska court could apply Alaska law and nonetheless invalidate the trust on the basis that it is a "sham" or the alter ego of the settlor. Because many of these trusts will be used chiefly to provide asset protection, the settlor will be the primary (or only) beneficiary. He or she may also be a co-trustee, a protector, or otherwise retain significant control over the trust. A court faced with these facts might be very receptive to an argument that the settlor is not really a "discretionary" beneficiary, as Alaska law requires.[13] Moreover, pursuant to a pattern of behavior revealing a relationship between the trustee and settlor suggesting that the settlor did not, in fact, part with dominion and control over the trust assets, the creditor might persuade a court to disregard the trust structure because it is a sham or the alter ego of the settlor.

Community Property Claims and the Alaska Law

Another dispute in which a court might choose to apply the law of the debtor's domicile, and not Alaska law, is in the context of a community property claim. In the states that have adopted a community property system of marital property ownership (for example, California, Texas, and New Mexico), with few exceptions, all property acquired during a marriage belongs equally to both spouses, regardless of which spouse actually earned it. Thus, the validity of a claim against trust assets made by the spouse of a settlor domiciled in a community property state would have to be decided under the law of the settlor's domicile, even in an Alaska court.

Therefore, although the new Alaska law, in Section 13.36.310, provides that no trust or transfer is void or voidable because it "avoids or defeats a right, claim, or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of marital or similar right," this law probably will not affect determinations of whether the trust assets are rightfully the property of a settlor's spouse.

Discovery by the creditor to reveal facts indicative of such a pattern of behavior will be accomplished under U.S. procedural rules, which have been promulgated pursuant to the due process guarantees of the Constitution. This contrasts sharply with discovery attempts in foreign countries concerning facts related to foreign trust activities, which may be a fairly burdensome, if not impossible, task.

Fraudulent Transfer. The non-Alaska court also could apply Alaska law, but nonetheless permit a creditor to reach trust assets by determining that the judgment debtor's transfer of assets to the Alaska trust was a fraudulent transfer under applicable state law. If the creditor prevails, the transfer of such assets to the trust will be void, resulting in full ownership and possession of such trust assets by the settlor, free of any trust and subject to the creditor's claim. It should be possible for a judgment creditor to bring the post-judgment fraudulent transfer claim in an Alaska court in connection with the creditor's appearance to enforce the underlying judgment on the merits via full faith and credit. It also should be possible, however, for such a claim to be heard and judgment rendered in a non-Alaska court that has jurisdiction over the judgment debtor.

Enforcement. Even though a non-Alaska court might render a judgment in favor of the creditor pursuant to one of the three foregoing arguments, the creditor's battle is not over. The creditor must also find a way to have this second judgment enforced against the assets of the Alaska asset protection trust. If the court's jurisdiction is based on the situs of trust assets, the court should be able to force the turnover of those assets from the judgment debtor to the creditor by a court order (for example, attachment or garnishment) that forces the party in possession of the assets to give them to the judgment creditor. However, if the court has jurisdiction over the trustee or settlor but not over the assets, the situation will be different. The court might issue a turnover order against the trustee or the settlor or both, but unless the trust itself had been invalidated in the post-judgment proceeding (for example, if the court had determined that the trust was a sham), a well-drafted trust instrument might make it impossible for the trustee to comply (possibly through an "anti-duress" clause requiring a trustee or protector to ignore orders compelling distributions). A valid Alaska trust also would not allow the settlor to compel distributions or to terminate the

trust.[14] Therefore, both the trustee and the settlor might be able to claim the defense of "impossibility."[15] The creditor would then have to take the judgment to the state where the trust assets are located to enforce the judgment obtained in the post-judgment proceeding.[16] If that state is Alaska or any other state of the United States, the judgment should be enforced pursuant to the application of the full faith and credit clause of the Constitution, and the court will order the turnover of trust assets located in that state.

If the trust assets were located offshore in a foreign trust, on the other hand, this entire exercise largely would have been a waste of time for the creditor.[17] This is because the laws of most offshore jurisdictions do not permit the recognition and enforcement of outside judgments and would require that the entire matter be retried in their courts under local procedural rules, which are likely to be much more debtor-friendly. The creditor would have to hire local counsel to deal with the unfamiliar legal system, adding significantly to expense (particularly because many offshore jurisdictions, such as the Cook Islands and Liechtenstein, have a loser-pay regime), while the odds of success are stacked against him by the system.

In contrast to foreign asset protection jurisdictions, Alaska, simply by virtue of its statehood, affords the creditor a much greater opportunity to reach trust assets. Alaska is bound by the Constitution and federal statutes to give full faith and credit to judgments rendered by the courts of sister states.[18] As long as the deciding court had proper jurisdiction, and the judgment was not procured by fraud, Alaska must recognize it and give it the full effect that such judgment would have had if rendered by an Alaska court.[19] This rule applies even if the other state's court rendered its judgment based upon a misapprehension of Alaska law and even if the judgment was based on a cause of action that would be against Alaska law and public policy.[20] Furthermore, the Restatement of Judgments provides that a cause of action for money "merges" into the judgment, and that a judgment for money by itself—the underlying cause of action having been resolved—cannot offend the public policy of a jurisdiction that simply is recognizing a judgment.[21] Thus, a creditor could procure a non-Alaska judgment in a post-judgment enforcement proceeding against trust assets and present it to an Alaska court. The Alaska court would have no choice but to honor the judgment.

Exemptions. Whether assets are exempt from the claims of creditors is determined by the law of the forum.[22] Accordingly, an attempt by a creditor to enforce a judgment against the settlor of a self-settled discretionary trust in Alaska would be unsuccessful if the creditor could not prove a fraudulent conveyance, sham, or alter ego claim. In other words, when a creditor requests an Alaska court to enforce a sister state judgment against the settlor of an Alaska asset protection trust, the Alaska court would be entitled to use Alaska exemption laws to determine what assets the creditor can reach. The new Alaska trust law exempts self-settled discretionary trusts from claims of both the settlor's and the beneficiaries' creditors. However, if an Alaska court was sympathetic to the creditor, it is possible that the court would employ another state's exemption law. The Restatement on Conflict of Laws permits the law of the forum to give way when another state has the dominant interest in the matter before the court. The court could decide that another state (such as the debtor's domicile) had a more significant interest in the matter and use that state's law. Because no other state has an exemption for assets held in

self-settled discretionary trusts, the trust assets would no longer be protected.

If, on the other hand, the sister state judgment by its terms permits the creditor to access trust assets located in Alaska or otherwise subject to the jurisdiction of Alaska courts, Alaska's new law will not protect the assets. That is because Alaska courts are precluded by full faith and credit from questioning the judgment itself.

Therefore, if the judgment declares that a particular trust asset belongs to the creditor on the basis that non-Alaska state law governs the enforcement proceeding against assets of the self-settled trust, Alaska courts cannot revisit the issue. The court would have no choice but to order that the necessary steps be taken to turn that asset over to the creditor. This concept would also apply if a judgment of a court of a sister state court voided a transfer to an Alaska trust under its own fraudulent transfer law or found the trust to be either a sham or the alter ego of the settlor. Alaska courts would be forced to honor such a ruling and either order that the party in possession of the trust assets turn the assets over to the creditor or order that the trust assets be returned to, or be deemed to be held by, the settlor. If the the court orders the latter, the creditor would then be able to reach the assets by suing in the debtor's state of domicile.

Supremacy Clause Concerns

In some instances, a judgment creditor facing a judgment debtor who has been rendered "insolvent" by virtue of a transfer to an asset protection trust will force the debtor into involuntary bankruptcy. In that case, pursuant to a judgment against the settlor rendered by a U.S. Bankruptcy Court under Bankruptcy Code rules, it is possible that the Constitution's supremacy clause[23] will come into play. Article VI, Section 2 of the U.S. Constitution provides that

> [T]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to Contrary notwithstanding.

The Bankruptcy Code takes precedence over any conflicting Alaska law as a result of the effect of the supremacy clause.

Typically, a debtor will argue that Section 541(c)(2) of the Bankruptcy Code exempts his or her beneficial interest in a trust that is subject to restrictions on its transfer which restrictions are enforceable under applicable nonbankruptcy law. The debtor's position would be that the "applicable nonbankruptcy law" is that of the trust, not the debtor's domicile. Accordingly, the restrictions on the debtor/beneficiary's ability to transfer trust assets of an Alaska trust should be determined by looking to Alaska law.[24]

The creditor, on the other hand, could advance two arguments against the use of Alaska law to determine whether the trust assets are exempt from creditors' claims. One of these implicates the supremacy clause. First, the creditor could contend that Section 541(c)(2) does not apply in the case of an Alaska asset protection trust. To support this argument, the creditor could point out that the legislative history of Section 541(c)(2) indicates that it was intended to protect "spendthrift trusts,"[25] arguably in the traditional understanding of such trusts, which are trusts created by one party for the benefit of another party that contain provisions restricting the beneficiaries' ability to transfer or assign their interests in the trust. The argument would assert that not only were Alaska asset protection trusts not

contemplated when Congress considered passing Section 541(c)(2), but they are not "spendthrift trusts" as understood by Congress at such time. Hence, prior to the passage of the Alaska statute, only trusts settled by someone other than the debtor could contain valid spendthrift provisions or other restrictions prohibiting hypothecation or alienation of trust assets that protect the debtor. Furthermore, a creditor could argue that language of the new Alaska statute which protects Alaska trusts from creditors' claims[26] is not a restriction on transfers within the meaning of Section 541(c)(2). Instead, it is in the nature of an exemption.[27]

If a creditor could convince a bankruptcy court that a beneficial interest in an Alaska self-settled trust either was not the sort of interest Congress intended to protect under Section 541(c)(2) or that the Alaska statute does not contain a restriction on transfers within the meaning of Section 541(c)(2), then the debtor would be faced with the prospect of arguing that the protection afforded Alaska trusts by the Alaska statute was an exemption to be respected independently of Section 541(c)(2). By virtue of the supremacy clause, however, this argument would be successful only if made by an Alaska debtor because Section 522(b)(2) of the Bankruptcy Code provides that the exemptions to be applied in bankruptcy are those of the debtor's domicile state, regardless of where the assets subject to the exemption are located. Thus, unless the settlor was an Alaska domiciliary, Section 522(b)(2) (due to the supremacy clause) would mean that the debtor's home state, lacking an exemption for self-settled trusts, would apply. Therefore, the trust assets would be reachable by the creditor under the domiciliary state's rule against creditor protective self-settled trusts.

Additionally, the creditor could plead (alternatively) that even if Section 541(c)(2) did apply, the "applicable non-bankruptcy law" should be determined by a "governmental interest" or "significant relationship" test, asserting that the interests of the debtor's domicile prevail over those of Alaska. Thus, the enforceability of transfer restrictions under Section 541(c)(2) should be determined under the domiciliary state's laws.[28]

Contract Clause Problems

The Constitution prohibits states from enacting any law that impairs the "Obligation of Contracts."[29] This provision is known as the "contract clause," and was specifically intended by the framers to prevent the states from passing extensive debtor relief laws.[30] In order to run afoul of the contract clause, the law in question must substantially impair the obligations of parties to existing contracts, or make them unreasonably difficult to enforce.[31] Furthermore, it must do so retroactively, affecting parties to existing contracts as well as parties to those drawn up after the law's passage.

Even when the law meets these criteria, it is not automatically void; instead, it is subjected to the "strict scrutiny" standard of review: that is, to be valid, it must be narrowly tailored to promote a compelling governmental interest.[32] A creditor has a potential legitimate argument that the new Alaska statute violates the contract clause by eliminating the creditor's ability to seize assets to which he would otherwise have had access before the enactment of such statute. Even though the U.S. Supreme Court has in the past recognized a distinction between laws that regulate the substantive obligations of contracts and those that merely regulate the remedies for breach of those contracts, this

distinction is no longer rigidly followed. Moreover, a creditor could argue that the Alaska statute does not just affect the remedies of the creditor, but it also alters the substantive obligations of the settlor/debtor. Because the settlor can potentially continue to use the assets that have been "discretionarily" distributed, the settlor's enjoyment of the trust assets is not impaired, but the possibility of creditors reaching those assets is restricted.

Because the debtor will not be harmed if he or she refuses to repay the debt, the debtor's obligation to do so becomes illusory. A creditor could argue that by changing its law to allow the assets of discretionary self-settled trusts to be protected from creditor's claims, Alaska has thwarted the repayment obligations of debtors who choose to set up such a trust. While a full review of debtors' potential arguments in defense of a contract clause violation are beyond the scope of this article, one defense would be an argument that fraudulent transfer laws offset the impairment of creditor/debtor contracts inherent in Alaska's new law, providing present and foreseeable creditors with a viable remedy when faced with a debtor who has transferred assets to avoid his or her repayment obligation.

Alaska's Questionable Status as a Pro-Debtor Jurisdiction

Even though many of the barriers to Alaska's entry into the asset protection arena exist because of Alaska's status as one of the United States, problems also exist with the statute itself as written, as well as with existing provisions of Alaska law. In other words, even if Alaska is not prevented by the U.S. Constitution from becoming an asset protection trust haven, the new statute does not give the maximum possible protection to settlors. This is due to the failure of the legislation to control the effect of other aspects of Alaska law.

Fraudulent Transfers Under Alaska Law. Two principal uniform laws form the basis of fraudulent transfer law in most states: the 1918 Uniform Fraudulent Conveyance Act (UFCA) and the 1984 Uniform Fraudulent Transfers Act (UFTA). Alaska has enacted neither. Its statute simply declares that transfers are void if made with "intent to hinder, delay, or defraud" creditors.[33] Unlike the two uniform laws, the Alaska law makes no attempt to define the term "creditor," leaving the class of plaintiffs as broad as the courts wish to make it, potentially including unknown future creditors, a class of creditors that neither the UFCA nor the UFTA include in their definition of creditor.

At first glance, one of the potential key advantages of Alaska's fraudulent transfer statute seems to be that it does not acknowledge the existence of "badges of fraud," which are circumstances surrounding the transfer that by themselves are considered evidence of an intent to defraud, thereby easing a creditor's burden of proof.

However, the Supreme Court of Alaska has acknowledged repeatedly the existence of at least eight badges of fraud in its opinions.[34] Six of these badges are quite similar to items on the UFTA list of badges of fraud. Two, however, are by their language much broader than any of the UFTA badges:

1. *The depletion of the assets of a transferor so "as to hinder or delay creditor recovery."*[35] Both the UFTA and UFCA consider transfers that render the debtor "insolvent" to be suspect, but the Alaska precedent as established by its Supreme Court would allow a creditor-friendly court

to go much further. In fact, it can be argued that the creditor would not be in court at all unless his or her attempts at recovery were "hindered or delayed" by a depleting transfer.[36]

2. *Transfers made when the relationship between the transferor and transferee is such that "there are circumstances which of themselves incite distrust and suspicion."*[37] The UFTA recognizes "transfers made to insiders"[38] as a badge of fraud, but the Alaska language could include almost anyone, allowing a court to view virtually any relationship as suspicious. Specifically, the relationship between a settlor and his or her self-settled trust would seem by its very nature to fit within the Alaska "circumstances which … incite distrust and suspicion" language.

More importantly, the Alaska fraudulent transfer statute does not specify a burden of Therefore, a creditor-friendly court could presumably extend the limitations period forever by declaring that the creditor could not have "reasonably discovered" the transfer until just before he brought suit.

Many offshore asset protection jurisdictions have provisions in their laws that either limit or nearly deny a creditor's ability to pursue a fraudulent transfer action. The Cook Islands, for example, limits such challenges to creditors of the settlor whose causes of action are less than two years old at the time of transfer to the trust and gives them one year from the date the trust was settled to sue.[42] Badges of fraud are not only statutorily denied as a concept, but the Cook Islands statute lists several common badges of fraud, specifically denying the evidentiary effect of each. For example, the statute specifically denies that an intent to defraud a proof on the creditor seeking to establish that a fraudulent transfer took place. In most states, civil fraud (including fraudulent transfer) must be proven by "clear and convincing evidence," a very high standard for a creditor to meet.[39] In Alaska, the burden is proof by a "preponderance of evidence," the burden of proof in most civil lawsuits.[40] This means that a creditor needs much less convincing evidence to void a transfer in Alaska than in most other states. Therefore, due to the combination of (1) no definition of "creditor," (2) broad badges of fraud, and (3) a low standard of proof, a creditor presumably would have *less* difficulty voiding transfers to trusts under Alaska law than under the law of most other states.

Furthermore, the statute of limitations for fraudulent transfers in Alaska is creditor-friendly, even as amended by the new legislation. Existing creditors of the settlor have the later of four years from the date of the transfer to bring suit or one year from the date the creditors could have "reasonably discovered" the transfer.[41] creditor will be imputed to a debtor who transfers all of his or her assets to a Cook Islands trust while that creditor's cause of action against him or her is pending in court.[43] The burden of proof is likewise placed on the creditor, who must meet the burden of proof "beyond a reasonable doubt,"[44] the highest standard possible, which generally is used in the United States only in criminal cases.

Alaska would likely run afoul of the U.S. Constitution if it attempted certain of the Cook Islands' tactics. Indeed, Cook Islands-type provisions would not only implicate the contract clause issues previously discussed, but also would raise significant procedural due process concerns.

However, the fraudulent transfer statute in Alaska probably could be rewritten (arguably without U.S. Constitutional

U.S. Constitutional Arguments in Perspective

The Constitutional analysis in this article discusses the three potential U.S. Constitutional arguments a judgment creditor might advance when faced with the challenge of reaching assets of an Alaska asset protection trust to satisfy his or her judgment. As an initial observation, it probably goes without saying that a creditor would have *no* U.S. Constitutional arguments to advance if dealing with a foreign asset protection trust. In the analysis of the U.S. Constitutional arguments with regard to Alaska trusts, however, it is important to keep the *effect* of such arguments in perspective.

The effect of a "full faith and credit" argument is to weaken the Alaska statute by permitting judgments rendered under non-Alaska law to be enforced against assets of Alaska asset protection trusts in spite of the fact that such judgment might not have been rendered under Alaska law. It should also be noted that full faith and credit does not help debtors force the application of Alaska law in other states. State courts are free to apply laws other than the governing law of the trust in appropriate circumstances. In this context, full faith and credit applies to judgments, not statutes.*

In contrast to the weakening effect of the full faith and credit argument, the effect of a successful contract clause claim would be to invalidate the part of the Alaska statute that impairs contracts by protecting discretionary beneficial interests in self-settled trusts from the claims of settlors' creditors. Even though a contract clause argument would probably be hard fought, especially considering the mitigating effect of fraudulent transfer law in Alaska, the contract clause argument is probably the only viable Constitutional claim that could potentially obliterate the Alaska asset protection trust law.

Finally, the supremacy clause argument has yet another effect. Applicable in this case only in the bankruptcy context, the supremacy clause dictates that the provision of the Bankruptcy Code requiring exemption laws of the settlor's domicile to be applied reigns supreme. Accordingly, assuming a creditor could convince a bankruptcy court that the exemption for beneficial interests in trusts under Section 541(c)(2) should not protect assets of Alaska protection trusts, it is possible that only Alaska domiciliaries would benefit from the new Alaska law in the bankruptcy context. Unlike the weakening or invalidating effect of the full faith and credit and contract clause arguments (respectively), the supremacy clause has the possible effect of narrowing the possible class of persons who might benefit from the new statute.

*Cf. R. Hompesch, G. Rothschild, and J. Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" 2 J. of Asset Prot. 6 (Jul/Aug 1997), at 9, 13.

implications) to deny the existence of badges of fraud, leaving the much harder to prove "intent to defraud" as the only way for a creditor to void a transfer. The burden of proof a creditor must meet could also be tightened to "clear and convincing evidence," because it is likely that shifting to a "beyond a reasonable doubt" standard would be a step too far. Finally, a definition of "creditor" and making the distinctions between present, probable, and unknown creditors also could lend more certainty to the fraudulent transfer analysis. Each of these changes presumably could be accomplished without Constitutional concerns because the concepts exist under

the fraudulent transfer laws of many other states. By making it harder for a creditor to win a fraudulent transfer argument, these changes also would greatly enhance the asset protection offered by Alaska trusts.

The Uniform Foreign Money Judgments Recognition Act. Alaska is one of the minority of states that has passed the Uniform Foreign Money Judgments Recognition Act. This act requires Alaska to recognize and enforce all foreign judgments that grant or deny recovery of a sum of money "in the same manner as the judgment of a sister state which is entitled to full faith and credit."[45] As long as the judgment was rendered by an impartial tribunal having valid jurisdiction, judgment against the settlor anywhere in the world could potentially result in delivery of trust assets to the creditor.

The Alaska version of the Act requires no reciprocity for enforcement. Therefore, whether the rendering country would give an Alaska judgment the same effect is irrelevant. Hence, although an Alaska judgment would be unenforceable in every offshore jurisdiction where asset protection trusts commonly are settled, any judgment rendered in a foreign country would be given the equivalent of full faith and credit in Alaska.

Again, this problem could be addressed by amending the statute. The Act could be amended so that it would not apply to trusts and settlors of trusts, or the Act could be abandoned altogether. Because this law involves only the recognition of foreign judgments, abandoning it would not have any Constitutional implications. However, Alaska would still be required to recognize a foreign judgment if an international convention between the United States and the nation in which the judgment was rendered so provided.[46]

The Availability of Punitive Damages and Attorney's Fees. When a creditor sues to have a transfer rendered void as fraudulent, the creditor often seeks both attorney's fees and punitive damages. Under Alaska law, all costs, including attorney's fees, are awarded to the victor in all civil lawsuits.[47] This is an extremely creditor-friendly provision and an anomaly in U.S. law. Punitive damages are awarded only for torts,[48] but that does not necessarily preclude a creditor-plaintiff from receiving them. Although a creditor's underlying cause of action may be based on contractual principles, he or she may have a specific tort claim (such as civil fraud) related to that action. Also, even though there is no law specifically on point in Alaska, fraudulent transfer claims are generally considered tort actions in that they are classified as civil fraud cases. In such a case, the possibility of both punitive damages and attorney's fees is present and could cause the creditor's award to rise far above his or her actual damages.

The new Alaska statute could be amended to deny punitive damages for plaintiffs challenging transfers to trusts and to plaintiffs seeking to invalidate trusts in general.[49] In addition, the statute authorizing plaintiffs' recovery of attorney's fees and costs could be amended to exclude such challenges to transfers to trusts. Otherwise, because creditors may be able to collect far more than they are owed by properly structuring their pleadings and are guaranteed their costs of litigation if they win, they will be more willing to sue.

Conclusion

Alaska's new legislation purports to give settlors a viable alternative to locating their asset protection trusts offshore. It is at best only partially successful. The statute

itself requires significant work to close creditor-friendly loopholes, but the major problem Alaska faces is that it is one of the fifty United States and therefore is subject to the restrictions of the U.S. Constitution. Alaska is unable to bring its law in line with the more aggressive asset protection laws in some offshore jurisdictions, because to do so would violate constitutional mandates. More importantly, Alaska's statehood prevents it from being able to control fully a creditor's right to obtain and enforce judgments against trust assets. Therefore, a settlor who is contemplating choosing Alaska as the jurisdiction for an asset protection trust must realize that Alaska cannot protect assets as well as an offshore jurisdiction. Although there may be other reasons for locating an asset protection-type trust in Alaska, the state cannot match offshore jurisdictions when it comes to the primary reason for creating such a trust: shelter from the claims of creditors.

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[1]U.S. Const., Art. IV, § 1.
[2]U.S. Const., Art. I, § 10.
[3]U.S. Const., Art. VI, § 2.
[4]See, e.g., Milliken v. Meyer, 311 US 457 (1940).
[5]See, e.g., International Shoe Co. v. Washington, 326 US 310 (1945).
[6]Restatement 2d, Conflict of Laws, § 41 (1971).
[7]See, e.g., International Shoe Co. v. Washington, 326 US 139 (1868); Gulf Oil Corp. v. Gilbert, 330 US 501 (1947).
[8]See, e.g., Green v. Van Buskirk, 72 US 307 (1866); 74 US 139 (1868).
[9]*Id.*
[10]See, e.g., Scott on Trusts, § 626(c) (4th ed. 1989); First Nat'l. Bank v. Nat'l Broadway Bank, 156 NY 459, 51 NE 398 (1898).
[11]With regard to trusts, see, e.g., In re Larry Portnoy, 201 BR 685 (Bankr. SDNY 1996); First Nat'l Bank in Mitchell v. Dagget, 497 NW.2d 358 (Neb. 1993). With regard to the general principle that foreign law will not be used if it contravenes the forum state's public policy, see, e.g, then-Judge Cardozo's opinion in Loucks v. Standard Oil Co, 120 NE 198 (NY 1918); see generally, Scoles and Hay, Conflict of Laws, § 3.15 et. seq. (2d ed. 1993).
[12]All states that have dealt with this issue have declared, either by statute or case law, that spendthrift provisions in self-settled trusts are void against existing creditors and that a wholly discretionary interest retained by the settlor will be interpreted in light of the trustee's discretionary authority to distribute *all* trust assets, thereby allowing creditors complete access to them. See, e.g., D. Osborne, Asset Protection: Domestic and International Law and Tactics, Ch. 14 (1997). For example, in Texas,

> [p]ublic policy does not countenance devices by which one frees his own property from liability for his debts, or restricts his power of alienation of it; and it is accordingly universally recognized that one cannot settle upon himself a spendthrift or other protective trust, or purchase such a trust from another, which will be effective to protect either the income or the corpus against the claims of his creditors, or to free it from his own power of alienation. The rule applies in respect of both present and future creditors and irrespective of any fraudulent intent in the settlement or purchase of a trust.

In re Shurley, 1997 WL 298546 (5th Cir., 1997), citing Glass v. Carpenter, 330 SW.2d 530. 533 (Tex. Civ. App. — San Antonio 1959, writ ref'd n.r.e). The Second Circuit, Seventh Circuit, and Tax Court have read the laws of New York, Indiana, and Maryland, respectively, to say that a settlor's discretionary right to income is not reachable by his or her creditors, but no state court has concurred with this conclusion. Furthermore, commentators have correctly noted that settlors have not chosen to rely on the circuit courts' interpretation. See, e.g., R. Hompesch, G. Rothschild, and J. Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" 2 J. of Asset Prot. 6 (Jul/Aug 1997), at 9. Missouri Revised Statutes § 456.080 has been interpreted to allow creditor-proof discretionary trusts, but, again, settlors have not chosen to rely on its interpretation. Missouri courts have traditionally disallowed creditor protection for self-settled trusts, and the local bankruptcy court has specifically declared that the new statute does not change the "existing" rule prohibiting self-settled creditor protective trusts. In re Enfield, 133 BR 515 (Bankr. ED Mo. 1991).
[13]Alaska Stat. § 34-40-110.
[14]Alaska Stat. § 34-40-110.
[15]Many courts are suspicious of the defense of impossibility. A court has the option of confining the defendant in jail until he either produces the assets, or the court is satisfied the defense has merit. As the Supreme Court has said, "[his or her] denial of possession is given credit after demonstration that a period in prison does not produce the goods." Maggio v. Zeitz, 333 US 56, 76 (1948).
[16]Alternatively, the creditor would have the option of asking the court to issue a turnover order against the settlor with regard to future distributions. Presumably, the trustee would then cease making distributions to the settlor. The creditor would not benefit, but the settlor would lose the ability to enjoy the assets himself.
[17]Both the confinement for contempt and the application of a running turnover order could be applied to foreign trusts with a U.S. settlor. Both punish the settlor, at least temporarily, but neither provides any great likelihood that the assets will eventually be delivered to the creditor. It should be noted that the punishment of the settlor actually will be rather illusory because well-drafted trust instruments will include a provision that enables the foreign trustee to make distributions "for the benefit" of beneficiaries. Accordingly, the settlor may cease receiving direct distributions, but would still have all of his or her bills paid by the trustee.
[18]U.S. Const., Art. IV, § 1; 28 USC § 1738.
[19]See Scoles & Hay, Conflict of Laws (2d ed. 1992), at 968 - 986.
[20]See, e.g., Fauntleroy v. Lum, 210 US 230, 237 (1908).
[21]Restatement 2d, Judgments §§ 17, 18 (1982).
[22]Restatement 2d, Conflict of Laws, § 132 (1971).
[23]U.S. Const., Art. VI, § 2.
[24]See, e.g., In re Remington, 14 BR 496 (Bankr. NJ 1981) (court held that Pennsylvania law [the law of the trust] applies to determine extent of New Jersey debtor's right to trust assets). For further discussion, see R. Hompesch, G. Rothschild, and J. Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" 2 J. of Asset Protection 6 (Jul/Aug 1997), at 9, 13.
[25]See HR Rep. No. 595, 95th Cong., 1st Sess. 369 (1977).
[26]Alaska Stat. § 13-36-310.

[27]The Alaska statute simply denies creditor access to self-settled discretionary trusts. Unlike certain other states' laws (e.g., Delaware), it does not statutorily confer "spendthrift trust" status on such trusts.
[28]See, e.g., In re Larry Portnoy, 201 BR 685 (Bankr. SDNY 1996) (holding that New York law should determine debtor's rights in a Jersey (Channel Islands) trust because "the trust, the beneficiaries, and the ramifications of [debtor's] assets being transferred into the trust have their most significant impact in the United States . . . and that application of Jersey's substantive law would offend strong New York and federal bankruptcy policies"). This second argument is similar to the argument a creditor might advance in a non-bankruptcy context to convince a court to not apply the governing law of the trust.
[29]U.S. Const., Art I, § 10.
[30]Wright, The Growth of American Constitutional Law 64 (1967); Home Building & Loan Assoc. v. Blaisdell, 290 US 398, 427 - 428 (1934) (Justice Hughes discussing historical background of the contract clause).
[31]See Wright, The Contract Clause of the Constitution (1938); Nowak and Rotunda, Constitutional Law (5th Ed. 1995), at 11.8.
[32]The U.S. Supreme Court first used the contract clause to invalidate a state law on the basis of unreasonable interference with contracts in Fletcher v. Peck, 10 US 87 (1810). The Court continued to use the clause for this purpose throughout the 1800s. See, e.g., Sturges v. Crowninshield, 17 US 122 (1819); Ogden v. Saunders, 25 US 213 (1827); Bronson v. Kinzie, 42 US 311 (1843). However, the clause fell into obscurity during the Court's "substantive due process" era, because "substantive due process" gave the Court greater discretion in passing on the constitutionality of state legislation. Thereafter, the contract clause was considered of little or no importance until its revival in 1977 in United States Trust Co. v. New Jersey 431 US 1 (1977). The next year, it was used by the Court to invalidate a statute for unreasonable interference with private contracts in Allied Structural Steel v. Spannaus, 438 US 234 (1978), and the Court has continued to use a contract clause analysis for this purpose. See, e.g., Exxon Corp. v. Eagerton 462 US 176 (1983); Energy Reserves Group, Inc. v. Kansas Power & Light Co. 459 US 400 (1983); Keystone Bituminous Coal Assoc. v. DeBenedictis 480 US 470 (1987); General Motors Corp. v. Romein 503 US 181 (1992).
[33]Alaska Stat. § 34-40-010.
[34]See, e.g., Roeckl v. FDIC, 855 P.2d 1067 (Alaska 1994); Pattee v. Pattee, 744 P.2d 658 (Alaska 1987); Sylvester v. Sylvester, 723 P.2d 1253 (Alaska 1986); Gabaig v. Gabaig, 717 P.2d 835 (Alaska 1986); First Nat'l Bank of Fairbanks v. Enzler, 537 P.2d 517 (Alaska 1975).
[35]Sylvester v. Sylvester, 723 P.2d 1253 (Alaska 1986); First Nat'l Bank of Fairbanks v. Enzler, 537 P.2d 517 (Alaska 1975).
[36]It can be argued that the new Alaska law, in § 13-36-310, makes this badge of fraud inapplicable to Alaska trusts because the statute states that no trust or transfer is void or voidable because it "avoids or defeats a right, claim, or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of marital or similar right." However, the language "hinder or delay creditor recovery" is so broad that the Alaska legislature should specifically abrogate it by revising § 13-36-310 specifically to make this badge of fraud inapplicable.
[37]First Nat'l Bank of Fairbanks v. Enzler, 537 P.2d 517 (Alaska 1975).
[38]UFTA, § 4(b)(1) (1984).
[39]See, e.g., Connecticut, Illinois, Iowa, Michigan, Missouri, Ohio, Virginia.
[40]Gabaig v. Gabaig, 717 P.2d at 839 (Alaska 1986).
[41]Alaska Stat. § 34-40-110.
[42]Cook Islands International Trusts Act 1984, § 13B(3).
[43]Id. at § 13B(5).
[44]Id. at §§ 13B(1), 13B(7).
[45]Uniform Foreign Money Judgments Recognition Act, 13 ULA 261, § 3; see Alaska Stat. § 09-30-100 et. seq.
[46]For example, the United States is a party to the Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters.
[47]Alaska Stat. § 09-60-010; Ak. RCP 82.
[48]Lee Houston & Assoc., Ltd. v. Racine, 806 P.2d 848, 856 (Alaska 1991).
[49]Some offshore jurisdictions—e.g., Liechtenstein—disallow punitive damage awards in all civil cases, based on public policy grounds.