

ALASKA LEGISLATURE COMMITTEE FILES, 2003-2004 86/2

10820 HOUSE JUDICIARY

ALASKA STATE LEGISLATURE

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Rep. Max Gruenberg



State Capitol, Room 120
Juneau, AK 99801-1182
(907) 465-4990
Fax (907) 465-6592

House Judiciary Committee

Memorandum

To: Leg. Legal
From: Vanessa Tondini, Committee Aide
House Judiciary Committee
Date: March 31, 2003
Re: CS Request

Please create a work draft House Judiciary Committee Substitute for work order # 23-LS0471\H, HB 212: Powers of Appointments/Trusts/Creditors, incorporating the attached changes. The bill will have its first hearing in House Judiciary on Wednesday, April 2nd, and we discovered this one last change to incorporate in the bill.

If you have any questions, please call me at 4990. Thank you!

The information attached to this memo is **CONFIDENTIAL** an/or privileged. It is intended to be reviewed initially by only the individual named above. If the reader of this Memorandum is not the intended recipient or a representative of the intended recipient, you are hereby notified that any review, dissemination, or copying of the information contained herein is prohibited. If you have received this in error, please immediately notify the sender by telephone and return this to the sender at the above address.

Sec. 7. AS 34.40 is amended by adding a new section to read:

Sec. 34.40.115. Subjecting appointed property to the claims of a donee's creditor.

The property that a donee of a power of appointment is authorized to appoint is not subject to the claims of the creditors of the donee except to the extent that a donee of an inter vivos or testamentary power of appointment

(1) is permitted by the donor of the power to appoint the property to the donee, the creditors of the donee, the donee's estate or to the creditors of the donee's estate; and

(2) effectively exercises the power of appointment in favor of the donee, the creditors of the donee, the donee's estate or to the creditors of the donee's estate.

23-LS0471N
Bannister
4/1/03

CS FOR HOUSE BILL NO. 212(JUD)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVE MCGUIRE

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to trusts, including trust protectors, trustee advisors, transfers of
2 property in trust, and transfers of trust interests, and to creditors' claims against
3 property subject to a power of appointment."

4 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

5 * **Section 1.** AS 13.36 is amended by adding new sections to read:

6 **Sec. 13.36.370. Trust protector.** (a) A trust instrument may provide for the
7 appointment of a disinterested third party to act as a trust protector.

8 (b) A trust protector appointed under (a) of this section has the powers,
9 delegations, and functions conferred on the protector by the trust instrument, which
10 may include the power to

11 (1) remove and appoint a trustee;

12 (2) modify or amend the trust instrument to achieve favorable tax
13 status or to respond to changes in 26 U.S.C. (Internal Revenue Code) or state law, or
14 the rulings and regulations under those laws;

1 (3) increase or decrease the interests of any beneficiary to the trust; and

2 (4) modify the terms of a power of appointment granted by the trust.

3 (c) A modification authorized under (b) of this section may not

4 (1) grant a beneficial interest to an individual or a class of individuals
5 unless the individual or class of individuals is specifically provided for under the trust
6 instrument;

7 (2) modify the beneficial interest of a governmental unit in a trust
8 created under AS 47.07.020(f).

9 (d) Subject to the terms of the trust instrument, a trust protector is not liable or
10 accountable as a trustee or fiduciary because of an act or omission of the trust
11 protector taken when performing the function of a trust protector under the trust
12 instrument.

13 **Sec. 13.36.375. Trustee advisor.** (a) A trust instrument may provide for the
14 appointment of a person to act as an advisor to the trustee with regard to all or some of
15 the matters relating to the property of the trust.

16 (b) Unless the terms of the trust instrument provide otherwise, if an advisor is
17 appointed under (a) of this section, the property and management of the trust and the
18 exercise of all powers and discretionary acts exercisable by the trustee remain vested
19 in the trustee as fully and effectively as if an advisor were not appointed, the trustee is
20 not required to follow the advice of the advisor, and the advisor is not liable as or
21 considered to be a trustee of the trust or a fiduciary when acting as an advisor to the
22 trust.

23 * **Sec. 2.** AS 34.40.110(a) is amended to read:

24 (a) A person who in writing transfers property in trust may provide that the
25 interest of a beneficiary of the trust, including a beneficiary who is the settlor of the
26 trust, may not be either voluntarily or involuntarily transferred before payment or
27 delivery of the interest to the beneficiary by the trustee. Payment or delivery of the
28 interest to the beneficiary does not include a beneficiary's use or occupancy of
29 real property or tangible personal property owned by the trust if the use or
30 occupancy is in accordance with the trustee's discretionary authority under the
31 trust instrument. In this subsection,

1 (1) "property" includes real property, personal property, and interests
2 in real or personal property;

3 (2) "transfer" means any form of transfer, including deed, conveyance,
4 or assignment.

5 * Sec. 3. AS 34.40.110(b) is amended to read:

6 (b) If a trust contains a transfer restriction allowed under (a) of this section,
7 the transfer restriction prevents a creditor existing when the trust is created or [,] a
8 person who subsequently becomes a creditor[, OR ANOTHER PERSON] from
9 satisfying a claim out of the beneficiary's interest in the trust, unless the creditor is a
10 creditor of the settlor and

11 (1) the settlor's transfer of property in trust was made with the
12 primary intent [INTENDED IN WHOLE OR IN PART] to [HINDER, DELAY, OR]
13 defraud that creditor [CREDITORS OR OTHER PERSONS UNDER
14 AS 34.40.010];

15 (2) the trust provides that the settlor may revoke or terminate all or
16 part of the trust without the consent of a person who has a substantial beneficial
17 interest in the trust and the interest would be adversely affected by the exercise of the
18 power held by the settlor to revoke or terminate all or part of the trust; in this
19 paragraph, "revoke or terminate" does not include a power to veto a distribution from
20 the trust, a testamentary nongeneral [SPECIAL] power of appointment or similar
21 power, or the right to receive a distribution of income, principal [CORPUS], or both
22 in the discretion of a person, including a trustee, other than the settlor, or a right to
23 receive a distribution of income or principal under (3)(A) or (B) of this
24 subsection;

25 (3) the trust requires that all or a part of the trust's income or principal,
26 or both, must be distributed to the settlor; however, this paragraph does not apply
27 to a settlor's right to receive

28 (A) income or principal from a charitable remainder
29 annuity trust or charitable remainder unitrust; in this subparagraph,
30 "charitable remainder annuity trust" and "charitable remainder
31 unitrust" have the meanings given in 26 U.S.C. 664 (Internal Revenue

1 Code) as that section reads on the effective date of this bill section and as
2 it may be amended;

3 (B) a percentage of the value of the trust each year as
4 determined from time to time under the trust instrument, but not
5 exceeding the amount that may be defined as income under AS 13.38 or
6 under 26 U.S.C. 643(b) (Internal Revenue Code) as that subsection reads
7 on the effective date of this bill section and as it may be amended; or

8 (4) at the time of the transfer, the settlor is in default by 30 or more
9 days of making a payment due under a child support judgment or order.

10 * Sec. 4. AS 34.40.110(c) is amended to read:

11 (c) The satisfaction of a claim under (b)(1) - (4) of this section is limited to
12 that part of the trust for [TO] which a transfer restriction is not allowed under
13 (b)(1) - (4) of this section, and an attachment or other order may not be made
14 against the trustee with respect to a beneficiary's interest in the trust or against
15 property that is subject to a transfer restriction, except to the extent that a
16 transfer restriction is determined not to be allowed under (b)(1) - (4) of this
17 section [APPLIES].

18 * Sec. 5. AS 34.40.110(d) is amended to read:

19 (d) A cause of action or claim for relief with respect to a fraudulent transfer of
20 a settlor's assets under (b)(1) of this section [, OR UNDER OTHER LAW,] is
21 extinguished unless the action under (b)(1) of this section is brought by a creditor of
22 the settlor [AS TO A PERSON] who

23 (1) is a creditor of the settlor before the settlor's assets are
24 transferred to the trust, and the action under (b)(1) of this section is brought
25 [WHEN THE TRUST IS CREATED,] within the later of

26 (A) four years after the transfer is made; or

27 (B) one year after the transfer is or reasonably could have been
28 discovered by the creditor if the creditor

29 (i) can demonstrate, by a preponderance of the
30 evidence, that the creditor asserted a specific claim against the
31 settlor before the transfer; or

1 that a donee of an inter vivos or testamentary power of appointment

2 (1) is permitted by the donor of the power to appoint the property to
3 the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
4 estate; and

5 (2) effectively exercises the power of appointment in favor of the
6 donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
7 estate.

8 * Sec. 8. The uncodified law of the State of Alaska is amended by adding a new section to
9 read:

10 APPLICABILITY. This Act applies to a trust regardless of whether the trust was
11 created before, on, or after the effective date of the applicable section of this Act.

Conceptual Amendment #1 to CSHB 212

A settlor of a trust is required to sign an affidavit of solvency prior to the creation of a trust. ✓

Conceptual
AMENDMENT 2
to HB 212

By Rep. Gruenberg

Section 6. AS 34.40.110

- 1 page 6, line 15, add a new section to read:
- 2 (8) the assets being transferred into the trust were not derived from unlawful activities.

House Bill 212 – Summary of Issues

CSED is concerned about this bill because it will make it easier for some parents to avoid supporting their children.

These are the primary problems that we see with this bill.

- (1) Section 2 (page 2, lines 25-26) of the bill allows the person creating the trust to also be the beneficiary of the trust and still receive protection from creditors. We have always considered that fact – that the settlor and beneficiary are the same person – as an indication of fraud. By adding this provision, the bill, if passed, would make it more difficult to prove a fraudulent transfer.
- (2) Section 2 (page 2, lines 27-31) of the bill states that a beneficiary (who can be the person creating the trust) can retain possession of the trust property and still receive protection from creditors. Normally, the fact that the person transferring the property retains possession of that property is an indication of fraud. The bill, if passed, would make it more difficult to prove a fraudulent transfer.
- (3) Section 3 (page 3, lines 9-10) of the bill limits the exceptions to trust protection to cases in which “the creditor is a creditor of the settlor.” However, it is often the beneficiary who is hiding behind or living off the trust. See example (b) in paragraph (6), below.
- (4) Section 3 (page 3, lines 11-12) of the bill increases the proof required to prove intent to defraud creditors. Currently, we only have to prove that the person intended *in part* to defraud creditors. There may have been legitimate reasons for the transfer, but if defrauding creditors was part of the intent, the trust will not be protected from creditors. If the bill passes, we will have to prove that defrauding creditors was the *primary* intent. This is much more difficult to prove, especially since we are talking about a *subjective* intent, which is hard to prove to begin with.
- (5) Section 3 (page 3, lines 25-31, and page 4, lines 1-7) of the bill allows persons to shelter their money from creditors in certain types of trusts even though the trust requires that all or a part of the trust’s income or principal be distributed to the person creating the trust. Thus, in some cases where we would argue there are clear indicia of fraud, the statutory protection against creditors would still apply.
- (6) Section 3 (page 4, lines 8-9) of the bill states the limited child support exception currently in AS 34.40.110(b)(4). This exception is not adequate to protect children because it only applies when the settlor was in default at the time of the transfer. This leaves some very large gaps. For example:
 - (a) A man receives a paternity complaint on January 1, 2000. Knowing that he is the child’s father and that the mother will demand child support from

him, he immediately creates a trust, something which he later claims that he had intended to do all along, not to avoid child support, but to take advantage of the tax benefits. A support order is established several months later. The father then refuses to pay support and arrears accrue. The father takes distributions from the trust in order to pay his living expenses and refuses to work, thus avoiding wage withholding. The child support exception would not apply because the settlor was not in default when he transferred the property into trust.

- (b) A man has a son who is not good with money. The man sets up a trust for his son, the income and principal of which are used to pay the son's living expenses. Thus, the son doesn't have to work to support himself. At some point, the son has a child but fails to pay child support. There is no need for him to work because he is able to live off the discretionary distributions from the trust. The child support exception wouldn't apply because it's the beneficiary who is in default.

Because the child support exception is very limited, CSED will be forced to rely on the "intent to defraud creditors" exception. CSED is concerned about this bill because it makes that exception much more difficult, if not impossible, to prove.

- (7) Section 5 (page 4, line 31, and page 5, lines 1-2) of the bill says that in order to avoid the transfer restriction based on an intent to defraud creditors, the creditor must show that "the creditor asserted a specific claim against the settlor before the transfer." This may make sense in the context of arms-length commercial transactions, but it does not work in the context of child support. In the commercial context, most claims are put in writing and thus are easy to prove. In the domestic arena, specific claims are rarely put in writing until long after the fact. Moreover, a specific claim is necessary for parents to know that they have a legal duty to support their children. There doesn't need to be any "specific claim" by the custodial parent or by CSED before the non-custodial parent knows enough to start hiding assets.
- (8) Section 6 (page 5, lines 6-15) of the bill extends the protections against creditors to situations where creditors are most likely to argue fraud. The provisions allow the person creating the trust to also be a beneficiary and co-trustee of the trust. They allow a beneficiary who is not the settlor to be the sole trustee. They also allow the person creating the trust to have the authority to appoint a trust protector who has super-powers over the trust. All of these provisions blur the lines between the concept of a trust and sole possession and control over property, making it that much more difficult to prove that there was an intent to defraud creditors.

Yes, CSED has many other enforcement tools, such as a criminal action for nonsupport and aiding and abetting. However, CSED's goal is not to put people in jail. Our goal is to assure that children receive the support to which they are entitled and that the state is

reimbursed for the money it spends to support these children when the parents don't. This bill will limit CSED's ability to accomplish that purpose in cases where income is being sheltered in trusts under these statutes.

One solution would be to broaden the child support exception of 34.40.110(b)(4) so that CSED does not have to rely on proof of an intent to defraud creditors in order to avoid the transfer restriction. This solution would simply state that the protections against creditors don't apply if the creditor is seeking to satisfy a child support debt.

AFFIDAVIT OF SOLVENCY

The undersigned, _____, makes oath and swears as follows:

1. That I am a Grantor of the _____ dated _____, and I may make transfers of property thereto in addition to my initial contribution.
2. That I have full right, title and authority to transfer the assets to the trust.
3. No particular event or transaction has occurred which I expect will develop into a controversy or problem with any creditor in the future.
4. There are no pending or threatened claims or lawsuits against me, and I am not a named Defendant in any lawsuits [except that named in the attached Schedule A] or involved in any administrative proceedings [except that named in the attached Schedule A] as of this date.
5. Following my transfers to the Trust, I will remain solvent and able to pay my reasonably anticipated debts as they become due, with due consideration to be given to the extent to which I have otherwise provided for the payment of any such debts.
6. This transfer represents less than one-half (1/2) of my net worth.
7. I am not engaged in or about to become engaged in a business or transaction for which my remaining assets will be unreasonable in relation to the business or transaction.
8. I do not intend to incur or reasonably believe that I will incur debts beyond my ability to pay as they become due, and I do not have the actual intent to hinder, delay or defraud any creditor.
9. I do not contemplate filing for relief under the provisions of the US Bankruptcy Code, nor am I involved in any situation that I reasonably anticipate would cause me to file for relief under any Chapter of the US Bankruptcy Code in the future.

- 10. I have read and understand the description of the Money Laundering Control Act, attached as Schedule B and confirm and represent that none of the assets which I may transfer was derived from any of the activities specified in such Act, and that none of the items of "financial misconduct" are applicable to me.
- 11. That I am not, nor do I reasonably expect to be, under investigation by any Federal or State Agency, or in violation of any statutes administered by, or empowering the Internal Revenue Service, the Federal Trade Commission, the Securities and Exchange Commission, the United States Postal Service, the Drug Enforcement Agency or the Federal Bureau of Investigation.
- 12. I am not in default by more than (30) days on child support payments. *

Sworn to and affirmed under penalties of perjury

Subscribed and sworn to before me by the said _____
this _____ day of _____

Notary Public
For the state of _____
My Commission expires: _____

The Money Laundering Control Act

The Money Laundering Control Act ("the Act") makes it criminal for anyone to conduct or attempt to conduct certain financial activities which involve the proceeds of unlawful activities. As the transfer of assets into a limited partnership, trust, or other entity may constitute a financial activity within the scope of the Act, it is necessary, that you swear under oath that none of the assets intended to be transferred into such entities was derived from any of the criminal activities specified in the Act.

The specified unlawful activities under the Act consist primarily of drug trafficking offenses, financial misconduct, and environmental crimes. Drug trafficking offenses include the manufacture, importation, sale, or distribution of controlled substances; the commission of acts constituting a continuing criminal enterprise; the illegal procurement of precursor; and transportation of drug paraphernalia.

Covered financial misconduct includes the concealment of assets from a receiver, custodian, marshal, or other officer of the court, from creditors in a bankruptcy proceeding, or from the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, or a similar agency or person; the making of a fraudulent conveyance in contemplation of a bankruptcy proceeding or with the intent to defeat the bankruptcy law; the giving of false oaths or claims in relation to a bankruptcy proceeding, bribery; the giving of commissions or gifts for the procurement loans; theft, embezzlement, or misapplication of bank funds or funds of other lending, credit, or insurance institutions; the making of fraudulent bank or credit institution entities or loan or credit applications; and mail, wire, or bank fraud or bank or postal robbery or theft.

Environmental crimes include violations of the Federal Water Pollution Control Act, the Ocean Dumping Act, the Safe Drinking Water Act, the Resources Conservation and Recovery Act, and similar federal statutes. Other specified crimes include counterfeiting, espionage, kidnapping or hostage-taking, copyright infringement, entry of goods by means of false statements, smuggling goods into the United States, removing goods from the custody of Customs, illegally exporting arms, and trading with United States enemies.

Schedule A

1. _____

2. _____

3. _____

4. _____

5. _____

6. _____

7. _____

8. _____

9. _____

ALASKA STATE LEGISLATURE

Rep. Lesil McGuire, Chair
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House Judiciary Committee

Memorandum

To: Terri Bannister, Leg. Legal
From: Vanessa Tondini, Committee Aide
House Judiciary Committee
Date: April 3, 2003
Re: CS Request

Please create a work draft House Judiciary Committee Substitute for work order # 23-LS0471N, HB 212, incorporating the attached two amendments. The bill will be brought back before the committee tomorrow, Friday, April 11 at 1:00pm, so if you could get the draft to me as soon as possible that would be wonderful!

If you have any questions, please call me at 4990. Thank you so much!

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Conceptual Amendment #1 to CSIR 212(JUD)

Add a new subsection to AS 34.40.110 (Page 5, Line 28):

- (k) A settlor who creates a trust which names the settlor as a beneficiary and whose beneficial interest is subject to a transfer restriction that is allowed under (a) of this section shall sign an affidavit, sworn to and affirmed under penalties of perjury, before the settlor makes a transfer of assets to the trust. The affidavit shall state that:
1. #2 of the attached affidavit; (rephrase to make consistent with the language of the bill).
 2. the transfer of assets to the trust will not render the settlor insolvent;
 3. the settlor has no intention to defraud a creditor by the transfer of assets to the trust;
 4. #4 of the attached affidavit; (rephrase to make consistent with the language of the bill)
 5. at the time of the transfer of assets to the trust the settlor is not currently in default of a child support obligation by more than 30 days; and
 6. #9 of the attached affidavit (rephrase to make consistent with the language of the bill).

Theresa: this change needs to be prospective and not retroactive like so many other aspects of the bill.

Amendment # 2

Page 3, Line 12:

Delete "primary"

23-LS0471VQ
Bannister
4/4/03

CS FOR HOUSE BILL NO. 212(JUD)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE MCGUIRE

A BILL
FOR AN ACT ENTITLED

1 **"An Act relating to trusts, including trust protectors, trustee advisors, transfers of**
2 **property in trust, and transfers of trust interests, and to creditors' claims against**
3 **property subject to a power of appointment."**

4 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

5 *** Section 1.** AS 13.36 is amended by adding new sections to read:

6 **Sec. 13.36.370. Trust protector.** (a) A trust instrument may provide for the
7 appointment of a disinterested third party to act as a trust protector.

8 (b) A trust protector appointed under (a) of this section has the powers,
9 delegations, and functions conferred on the protector by the trust instrument, which
10 may include the power to

11 (1) remove and appoint a trustee;

12 (2) modify or amend the trust instrument to achieve favorable tax
13 status or to respond to changes in 26 U.S.C. (Internal Revenue Code) or state law, or
14 the rulings and regulations under those laws;

1 (3) increase or decrease the interests of any beneficiary to the trust; and

2 (4) modify the terms of a power of appointment granted by the trust.

3 (c) A modification authorized under (b) of this section may not

4 (1) grant a beneficial interest to an individual or a class of individuals
5 unless the individual or class of individuals is specifically provided for under the trust
6 instrument;

7 (2) modify the beneficial interest of a governmental unit in a trust
8 created under AS 47.07.020(f).

9 (d) Subject to the terms of the trust instrument, a trust protector is not liable or
10 accountable as a trustee or fiduciary because of an act or omission of the trust
11 protector taken when performing the function of a trust protector under the trust
12 instrument.

13 **Sec. 13.36.375. Trustee advisor.** (a) A trust instrument may provide for the
14 appointment of a person to act as an advisor to the trustee with regard to all or some of
15 the matters relating to the property of the trust.

16 (b) Unless the terms of the trust instrument provide otherwise, if an advisor is
17 appointed under (a) of this section, the property and management of the trust and the
18 exercise of all powers and discretionary acts exercisable by the trustee remain vested
19 in the trustee as fully and effectively as if an advisor were not appointed, the trustee is
20 not required to follow the advice of the advisor, and the advisor is not liable as or
21 considered to be a trustee of the trust or a fiduciary when acting as an advisor to the
22 trust.

23 * **Sec. 2.** AS 34.40.110(a) is amended to read:

24 (a) A person who in writing transfers property in trust may provide that the
25 interest of a beneficiary of the trust, including a beneficiary who is the settlor of the
26 trust, may not be either voluntarily or involuntarily transferred before payment or
27 delivery of the interest to the beneficiary by the trustee. Payment or delivery of the
28 interest to the beneficiary does not include a beneficiary's use or occupancy of
29 real property or tangible personal property owned by the trust if the use or
30 occupancy is in accordance with the trustee's discretionary authority under the
31 trust instrument. In this subsection,

1 (1) "property" includes real property, personal property, and interests
2 in real or personal property;

3 (2) "transfer" means any form of transfer, including deed, conveyance,
4 or assignment.

5 * **Sec. 3.** AS 34.40.110(b) is amended to read:

6 (b) If a trust contains a transfer restriction allowed under (a) of this section,
7 the transfer restriction prevents a creditor existing when the trust is created or [,] a
8 person who subsequently becomes a creditor [, OR ANOTHER PERSON] from
9 satisfying a claim out of the beneficiary's interest in the trust, unless the **creditor is a**
10 **creditor of the settlor and**

11 (1) **the settlor's transfer of property in trust was made with the**
12 **intent** [INTENDED IN WHOLE OR IN PART] to [HINDER, DELAY, OR] defraud
13 **that creditor** [CREDITORS OR OTHER PERSONS UNDER AS 34.40.010];

14 (2) **the** trust provides that the settlor may revoke or terminate all or
15 part of the trust without the consent of a person who has a substantial beneficial
16 interest in the trust and the interest would be adversely affected by the exercise of the
17 power held by the settlor to revoke or terminate all or part of the trust; in this
18 paragraph, "revoke or terminate" does not include a power to veto a distribution from
19 the trust, a testamentary **nongeneral** [SPECIAL] power of appointment or similar
20 power, or the right to receive a distribution of income, **principal** [CORPUS], or both
21 in the discretion of a person, including a trustee, other than the settlor, **or a right to**
22 **receive a distribution of income or principal under (3)(A) or (B) of this**
23 **subsection;**

24 (3) **the** trust requires that all or a part of the trust's income or principal,
25 or both, must be distributed to the settlor; **however, this paragraph does not apply**
26 **to a settlor's right to receive**

27 (A) **income or principal from a charitable remainder**
28 **annuity trust or charitable remainder unitrust; in this subparagraph,**
29 **"charitable remainder annuity trust" and "charitable remainder**
30 **unitrust" have the meanings given in 26 U.S.C. 664 (Internal Revenue**
31 **Code) as that section reads on the effective date of this bill section and as**

1 it may be amended:

2 (B) a percentage of the value of the trust each year as
3 determined from time to time under the trust instrument, but not
4 exceeding the amount that may be defined as income under AS 13.38 or
5 under 26 U.S.C. 643(b) (Internal Revenue Code) as that subsection reads
6 on the effective date of this bill section and as it may be amended; or

7 (4) at the time of the transfer, the settlor is in default by 30 or more
8 days of making a payment due under a child support judgment or order.

9 * Sec. 4. AS 34.40.110(c) is amended to read:

10 (c) The satisfaction of a claim under (b)(1) - (4) of this section is limited to
11 that part of the trust for [TO] which a transfer restriction is not allowed under
12 (b)(1) - (4) of this section, and an attachment or other order may not be made
13 against the trustee with respect to a beneficiary's interest in the trust or against
14 property that is subject to a transfer restriction, except to the extent that a
15 transfer restriction is determined not to be allowed under (b)(1) - (4) of this
16 section [APPLIES].

17 * Sec. 5. AS 34.40.110(d) is amended to read:

18 (d) A cause of action or claim for relief with respect to a fraudulent transfer of
19 a settlor's assets under (b)(1) of this section [, OR UNDER OTHER LAW,] is
20 extinguished unless the action under (b)(1) of this section is brought by a creditor of
21 the settlor [AS TO A PERSON] who

22 (1) is a creditor of the settlor before the settlor's assets are
23 transferred to the trust, and the action under (b)(1) of this section is brought
24 [WHEN THE TRUST IS CREATED,] within the later of

25 (A) four years after the transfer is made; or

26 (B) one year after the transfer is or reasonably could have been
27 discovered by the creditor if the creditor

28 (i) can demonstrate, by a preponderance of the
29 evidence, that the creditor asserted a specific claim against the
30 settlor before the transfer; or

31 (ii) files another action, other than an action under

1 (b)(1) of this section. against the settlor that asserts a claim based
2 on an act or omission of the settlor that occurred before the
3 transfer, and the action described in this sub-subparagraph is filed
4 within four years after the transfer [PERSON]; or

5 (2) becomes a creditor subsequent to the transfer into trust, and the
6 action under (b)(1) of this section is brought within four years after the transfer is
7 made.

8 * Sec. 6. AS 34.40.110 is amended by adding new subsections to read:

9 (g) A transfer restriction allowed under (a) of this section and enforceable
10 under (b) of this section applies to a settlor who is also a beneficiary of the trust even
11 if the settlor serves as a co-trustee or as an advisor to the trustee under AS 13.36.375 if
12 the settlor does not have a trustee power over discretionary distributions.

13 (h) A transfer restriction allowed under (a) of this section and enforceable
14 under (b) of this section applies to a beneficiary who is not the settlor of the trust,
15 whether or not the beneficiary serves as a sole trustee, a co-trustee, or an advisor to the
16 trustee under AS 13.36.375.

17 (i) A transfer restriction is allowed under (a) of this section and is enforceable
18 under (b) of this section even if a settlor has the authority under the terms of the trust
19 instrument to appoint a trust protector under AS 13.36.370 or an advisor to the trustee
20 under AS 13.36.375.

21 (j) A settlor whose beneficial interest in a trust is subject to a transfer
22 restriction that is allowed under (a) of this section may not benefit from, direct a
23 distribution of, or use trust property except as may be stated in the trust instrument.
24 An agreement or understanding, express or implied, between the settlor and the trustee
25 that attempts to grant or permit the retention of greater rights or authority than is stated
26 in the trust instrument is void.

27 (k) A settlor who creates a trust that names the settlor as a beneficiary and
28 whose beneficial interest is subject to a transfer restriction allowed under (a) of this
29 section shall sign an affidavit before the settlor transfers assets to the trust. The
30 affidavit must state that

31 (1) the settlor has full right, title, and authority to transfer the assets to

1 the trust;

2 (2) the transfer of the assets to the trust will not render the settlor
3 insolvent;

4 (3) the settlor does not intend to defraud a creditor by transferring the
5 assets to the trust;

6 (4) the settlor does not have any pending or threatened court actions
7 against the settlor, except for those court actions identified by the settlor on an
8 attachment to the affidavit;

9 (5) the settlor is not involved in any administrative proceedings, except
10 for those administrative proceedings identified on an attachment to the affidavit;

11 (6) at the time of the transfer of the assets to the trust, the settlor is not
12 currently in default of a child support obligation by more than 30 days; and

13 (7) the settlor does not contemplate filing for relief under the
14 provisions of 11 U.S.C. (Bankruptcy Code).

15 * **Sec. 7.** AS 34.40 is amended by adding a new section to read:

16 **Sec. 34.40.115. Subjecting appointed property to claims of donee's**
17 **creditor.** The property that a donee of a power of appointment is authorized to
18 appoint is not subject to the claims of the creditors of the donee except to the extent
19 that a donee of an inter vivos or testamentary power of appointment

20 (1) is permitted by the donor of the power to appoint the property to
21 the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
22 estate; and

23 (2) effectively exercises the power of appointment in favor of the
24 donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
25 estate.

26 * **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to
27 read:

28 **APPLICABILITY.** (a) Except as provided by (b) of this section, this Act applies to a
29 trust regardless of whether the trust was created before, on, or after the effective date of the
30 applicable section of this Act.

31 (b) AS 34.40.110(k), enacted by sec. 6 of this Act, applies to a trust only if the trust is

1 created on or after the effective date of this Act.

LexisNexis(TM) CD

<http://198.187.128.12/delaware/lpext.dll/Infobase/12060/12af4/12be...>*Delaware***§ 3573. Persons not subject to qualified dispositions.**

Notwithstanding the provisions of § 3572 of this title, this subchapter shall not apply in any respect:

(1) To 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 in favor of such transferor's spouse or former spouse, to the extent of such debt; or

(2) To any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable. Paragraph (1) shall not apply to any claim for forced heirship or legitime.

(71 Del. Laws, c. 159, § 1; 71 Del. Laws, c. 254, § 36; 71 Del. Laws, c. 343, § 8; 72 Del. Laws, c. 341, § 9.)

18-9.2-5

<http://www.rilin.state.ri.us/Statutes/TITLE18/18-9.2/18-9.2-5.HTM>

Rhode Island

TITLE 18 Fiduciaries

CHAPTER 18-9.2 Qualified Dispositions in Trust

SECTION 18-9.2-5

§ 18-9.2-5 Persons not subject to qualified dispositions. – Notwithstanding the provisions of § 18-9.2-4, this chapter does not apply to defeat a claim brought by:

(1) Any person to whom the transferor is indebted on or before the date of a qualified disposition on account of an agreement or order of court for the payment of support or alimony in favor of the transferor's spouse, former spouse or children, or for a division of distribution of property in favor of this transferor's spouse or former spouse, to the extent of the debt; or

(2) To any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of either the transferor or by another person for whom the transferor is or was vicariously liable.

Nevada- No exceptions.

NRS 166.120 Restraints on alienation.

1. A spendthrift trust as defined in this chapter restrains and prohibits generally the assignment, alienation, acceleration and anticipation of any interest of the beneficiary under the trust by the voluntary or involuntary act of the beneficiary, or by operation of law or any process or at all. An exception is declared, however, when the trust does not provide for the application for or the payment to any beneficiary of sums out of capital or corpus or out of rents, profits, income, earnings, or produce of property, lands or personalty. In such cases, the corpus or capital of the trust estate, or the interest of the beneficiary therein, may be anticipated, assigned or aliened by the beneficiary voluntarily, but not involuntarily or by operation of law or by any process or involuntarily at all. The trust estate, or corpus or capital thereof, shall never be assigned, aliened, diminished or impaired by any alienation, transfer or seizure so as to cut off or diminish the payments, or the rents, profits, earnings or income of the trust estate that would otherwise be currently available for the benefit of the beneficiary.

2. Payments by the trustee to the beneficiary shall be made only to and into the proper hands of the beneficiary and not by way of acceleration or anticipation, nor to any assignee of the beneficiary, nor to or upon any order, written or oral, given by the beneficiary, whether such assignment or order be the voluntary contractual act of the beneficiary or be made pursuant to or by virtue of any legal process in judgment, execution, attachment, garnishment, bankruptcy or otherwise, or whether it be in connection with any contract, tort or duty.

3. The beneficiary shall have no power or capacity to make any disposition whatever of any of the income by his order, voluntary or involuntary, and whether made upon the order or direction of any court or courts, whether of bankruptcy or otherwise; nor shall the interest of the beneficiary be subject to any process of attachment issued against the beneficiary, or to be taken in execution under any form of legal process directed against the beneficiary or against the trustee, or the trust estate, or any part of the income thereof, but the whole of the trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefore.

4. The trustee of a spendthrift trust is required to disregard and defeat every assignment or other act, voluntary or involuntary, that is attempted contrary to the provisions of this chapter.

Past & Future Of

Alaska Trust

Legislation

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Legislation Passed Into Law 1997



HB 101 – Effective April 2, 1997

- Perpetual Trusts
- Self-Settled Spendthrift Trusts

HB 266 – Effective July 1, 1997

- Limited Partnership & LLC Improvements
Statute

Legislation 1998

SB 354 – Effective April 12, 1998

- General Modernization of Trust and Estate Laws

HB 199 – Effective May 23, 1998

- Alaska Community Property Trust

HB 321 – Effective May 23, 1998

- Alaska Uniform Prudent Investor Act

HB 490 – Effective June 26, 1998

- Life Insurance Premium Tax

HB 222 – Effective March 8, 2000

- **Improvements & Technical Changes to Limited Partnerships LLC Statute**

SB 166 – Effective March 8, 2000

- **Technical Changes to Alaska Community Property Trust**

SB 162 – Effective April 22, 2000

- **Modification to Perpetual Trust Statute**

HB 275 – Effective August 9, 2000

- **“Safety Net” Estate Planning Legislation**

SB 163 – Effective August 30, 2000

- **Modification and Improvement to General Trust Statutes**

Why Alaska

- Personal
- Familiar with Alaska Statutes and Estate Planning Professionals
- Estate Planning Professionals wanted Institutions that would Specialize in Trust and Investment Management Services
- No State Income Tax On Trusts & Estates

Has It Been Successful?



Yes Yes Yes

Positive Developments



Alaska Has Become Known Throughout the Country for Being Creative and Innovative Regarding its Trust Laws. Alaska is Considered the Leading Jurisdiction for Trust Administration.

Alaska's 1st Independent Trust Company

- Has 7 full time employees; 5 are born & raised Alaskans
- Pays State Corporate Income Tax
- Annually puts hundreds of thousands of dollars into the Alaska Economy
- We have on deposit with local banks (Northrim & 1st Interstate) Tens of Millions of dollars
- Over 700 clients have come to Alaska from other states

Professionals in Alaska Have Benefited



- Attorneys have increased business both from outside clients and Alaska clients
- CPA'S have increased business
- Insurance agents
- Stock brokers
- Others



**Alaskans have benefited directly
from the legislation**

**Many Alaskans are taking
advantage of the unique Trust &
Estate Legislation**

State Of Alaska



- Increase in Life Insurance Premium Taxes
 - Additional estimated 2001 Premium Tax of \$700,000.00 directly related to Trust Legislation
- Increase Corporate Income Tax
- Increase revenue from LLC & LP filings
- Insurance Companies are considering opening up subsidiaries in Alaska



All This Has Happened in
Less Than 5 Years With No
Financial Outlay From the
State

Why the Need to Have Additional Legislation

- Much of this Legislation is structured to meet IRS rules & guidelines. When IRS makes a change it may require a change in Alaska Statute to stay effective.
- Other states are trying to improve their Trust Laws. If they come up with a better approach we need to adjust in Alaska to stay effective.
- Fine tune legislation to make sure it is the best.

The Future Looks Very Bright for Alaska to Continue to Attract Business to the State. The Only Potential Problem Would Be the Implementation of an Income Tax on Trusts and Estates Set up by Non-Resident's.

The Implementation of Such a Tax Would Cause Alaska to Lose Within One Year 99% of the Business It Has Attracted. The Business Would Go to a State That Does Not Tax Non-Resident Trusts.

016



Thank You

ALASKA TRUST COMPANY

02/20/2003 11:43 FAX 9072581649

For your prior involvement and
hope for your continued support

Enact Beth's virtual representation bill

Amend AS 09.30.120(b)(3), to state that recognition of self settled trusts represent the strong public policy of this state. Truthfully an entire review of the Uniform Foreign Money-Judgments Recognition Act and the Uniform Enforcement of Foreign Judgments Act, as well as the Alaskan Supreme Court decisions under these acts should be undertaken to see if they can be tweaked. I think outright repeal would be impossible although only a minority of states have enacted these Acts, Alaska being one, and they are irrelevant to the extent that the U.S. Supreme Court has spoken. Personally I think they conflict with one another, as I don't see the possibility for a hearing, without the posting of a bond, under the Uniform Enforcement of Foreign Judgments Act.

Statute of limitations to bring action to enforce other state's judgments. Delaware enacted this statute.

Think about statutorily defining those items which constitute a badge of fraud and in the process eliminate the depletion of assets and one other badge that our Supreme Court has added to the language contained in the Uniform Fraudulent Transfer Act.

Provide a statute where an Alaskan court can substitute trustees change if trust attacked and a foreign court exercises jurisdiction over the Alaska trustee. I think this is suspect but Delaware has a similar statute.

Enact Rich's living probate bill.

Alaska Adopts a New Trust Law

The primary author of the legislation explains how it substantially improves creditor protection

By Stephen E. Greer, sole practitioner, Anchorage, Alaska

On July 10, Alaska Governor Frank Murkowski signed into law a new state trust bill that passed the 23rd Alaska legislature by unanimous vote. The provisions of this bill improve creditor protection for third-party beneficiary trusts and self-settled trusts, further enhancing Alaska's desirability as a place to create and maintain trusts. The most dramatic change for third-party beneficiary trusts is the ability of a third-party beneficiary to serve as sole trustee and still be protected from creditor claims. Now, for the first time, a domestic self-settled trust law limits the class of creditors that can be considered "pre-existing creditors" with the right to an unlimited statute of limitations during which to bring a fraudulent conveyance action against a settlor. But there is a lot more to Alaska's new laws.

DYNASTY TRUSTS

Changes in the law for dynasty trusts are, in order of importance:

No need to worry now that a judge might order a distribution, which a creditor could then attach.

- **COURTS CANNOT COMPEL DISTRIBUTIONS OR ATTACH BENEFICIAL INTEREST.** One of the principle reasons for creating a dynasty trust is to provide creditor protection for third-party beneficiaries. Creditor protection is dependent on the protection given by a spendthrift clause and the law of the state where the trust administration occurs. Alaska's spendthrift clause provides extremely powerful protection because it bars all creditors from attaching trust assets before payment or delivery of the assets to the beneficiary. This protection includes claims brought against a beneficiary by spouses for

support, ex-spouses for alimony, providers of necessities, tort creditors and claims for child support.³ This protection continues as long as the assets remain in trust and ends when the trust assets are paid or delivered to the beneficiary.⁴

Previously, practitioners were concerned that an Alaska judge might circumvent this protection by ordering the trustee to make a distribution to the beneficiary, which then could be attached by a creditor. That worry was put to rest by a provision in the new state law stating that an attachment or other order may not be made against the trustee with respect to a beneficiary's interest held in trust.⁵

• **BENEFICIARY CONTROL WITH NO LOSS IN PROTECTION.** In many circumstances, a settlor would like to give a beneficiary as

much control as possible, provided there is no loss in creditor protection. Toward this end, many settlors want the beneficiary to serve as the

Now one can name a non-resident beneficiary as a co-trustee without compromising creditor protection.

sole trustee. The trend in the law, however, is to treat a beneficiary serving as the sole trustee as having a limited form of ownership.⁶ The *Restatement of the Law Third, Trusts* provides that when a beneficiary is appointed as the sole


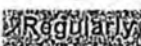



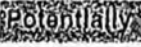

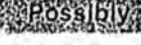
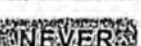
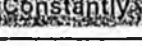
trustee, a claimant can reach the maximum amount that the beneficiary could distribute to himself.⁷ The bill, in marked contrast to the Restatement, provides a spendthrift provision will be valid, even though the beneficiary is appointed the sole trustee.

If a beneficiary is appointed the sole trustee, the beneficiary's authority to make a trust distribution to himself must be limited to an ascertainable standard that relates to the beneficiary's health,

education, maintenance or support, to avoid having the assets included in the beneficiary's taxable estate.⁸ This restriction might place an unwanted ceiling on the level of distributions that can be made to the beneficiary. To get around it, the trust instrument could provide that the beneficiary, serving as a co-trustee, would have the authority to make distributions to himself that are limited to an ascertainable standard, while an Alaskan trustee, independent of the beneficiary within the meaning of Internal Revenue Code Section 672(c), would have the authority to make distributions to the beneficiary unrelated to this standard.

If the beneficiaries are not residents of Alaska, there should be a direct expression of intent that the administration of the trust occur in Alaska, and that there always be one trustee who is a "qualified person" as defined in Alaska Statutes 13.36.390(2).¹⁰ Before the new Alaska law, creditor protection for non-residents could be achieved only by appointing an independent trustee with discretionary authority to make trust distributions. It is now possible to name a non-resident beneficiary as a co-trustee with distribution authority without compromising creditor protection.

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• **MERE POSSESSION OF A GENERAL POWER OF APPOINTMENT DOES NOT EXPOSE THE ASSETS TO CREDITOR CLAIMS.**

In every large estate, it is possible that distributions will be made to subtrusts — which may or may not be exempt from generation-skipping transfer taxes. Because the estate tax is progressive, federal taxes payable at death often will be less if the assets in a non-exempt trust are exposed to estate tax at the beneficiary's death (rather than having the assets exposed to generation-skipping transfer tax). To accomplish this, a beneficiary in a non-exempt trust can be given a testamentary general power of appointment that will result in the trust assets being included in the beneficiary's estate tax base.

One of the most important provisions of Alaska's new law states that a beneficiary can have a general power of appointment and the assets subject to this power can not be attached by the beneficiary's creditors.¹³ This protection exists regardless of whether the power of appointment is testamentary or presently exercisable.

The position of the *Restatement of the Law, Property Second* as it relates to both an unexercised testamentary general power of appointment and an unexercised but presently exercisable general power of appointment, is that the appointive assets cannot be subjected to the claims of a beneficiary's creditors, unless provided by statute.¹⁴ The theory is that until the donee exercises the power, he has not accepted enough control over the appointive assets to confer the equivalent of ownership.¹⁵ If a beneficiary exercises a testamentary or a presently exercisable general power of appointment, the appointive assets can be reached by creditors.¹⁶ Nonetheless, mere possession of a power of appointment, potentially exercisable in favor of a donee's cred-

itors, is considered a general power of appointment under Treasury Regulations Section 20.2041-1(c).

This provision is also important in any trust that has given a benefi-

Alaska has corrected a major defect common in self-settled laws. It now provides a definition for a "pre-existing creditor."

ciary a Crummey withdrawal right. The *Restatement of the Law Third, Trusts* considers a beneficiary with a Crummey right to be the owner of the property over which the rights could be exercised, thus exposing the trust to creditors' claims.¹⁷ In Alaska, a beneficiary can have a Crummey withdrawal right and the trust assets can be protected from creditors' claims.

• **USE PROVISIONS RESPECTED.** A use provision allows a trustee to make trust assets available to the beneficiary. The new Alaska law states that property may be made available for the use of a beneficiary without being considered a distribution, thus insulating the trust assets from the claims of a beneficiary's creditors.¹⁸

• **TRUST PROTECTORS AND TRUST ADVISORS ARE NOT CONSIDERED FIDUCIARIES.** No doubt better creditor protection can be achieved where an independent trustee is given the discretionary authority to make distributions. A frequent objection to this arrangement is the corresponding lack of control that a beneficiary

will have over the trust assets. To minimize this concern, settlors often give a trust protector the power to remove and replace the trustee. In the absence of state law to the contrary, however, a court could consider the trust protector a fiduciary, thus decreasing the possibility of finding someone willing to take on the trust protector role. The new Alaska law states that a trust protector will not be held accountable as a fiduciary.¹⁹

Additionally, a settlor might appoint a trust advisor who is personally knowledgeable about the beneficiary's circumstances to assist a corporate trustee. The appointment of an advisor greatly improves the chances of fulfilling the settlor's purpose. The new Alaska law states that an advisor will not be held accountable as a fiduciary.

SELF-SETTLED TRUSTS

Many of the protections applicable to third-party beneficiary trusts also apply to self-settled trusts. But the new law contains some very important changes that apply exclusively to self-settled trusts. In order of importance, they are:

• **CORRECTION OF MAJOR DEFECT IN SELF-SETTLED LEGISLATION.** The new Alaska law remedies a substantial defect contained in all other domestic self-settled trust legislation: the lack of a definition for a "pre-existing creditor." In all domestic self-settled jurisdictions, a "pre-existing creditor" has the benefit of what is essentially an unlimited statute of limitations to set aside a transfer of assets as a fraudulent conveyance.²⁰ A pre-existing creditor has an undefined period of time to make a fraud claim because the creditor might not reasonably discover the transfer of assets to a trust until many years afterwards.

Consider this example: A doctor,

unaware of any patient complaints, transfers property to a self-settled trust. Subsequent to the transfer, a patient who was seen prior to the transfer alleges he was negligently misdiagnosed. Should this patient be considered a "pre-existing creditor" even though the patient's claim was unknown to the doctor at the time the doctor transferred assets to the trust? If so, the patient would be allowed an unlimited period of time in which to assert a claim that the settlor's transfer in trust was fraudulent and to have the transfer in trust set aside. As a result, no doctor, no contractor or, for that matter, no individual who has ever been engaged in business for any length of time, could ever completely discount the possibility of a "pre-existing creditor" successfully attacking the trust.

The new Alaska law defines a "pre-existing creditor" as one who either:

- demonstrates, by a preponderance of the evidence, that he asserted a specific claim against the settlor before the settlor transferred assets to the trust; or
- within four years after the settlor transferred assets to the trust, files an action in court against the settlor asserting a specific cause of action based on an act or omission (for instance, a negligent surgery) that occurred before the transfer.

• **TIGHTENING THE DEFINITION OF A FRAUDULENT CONVEYANCE.** Before the new Alaska law was enacted, a transfer to a self-settled trust could be set aside if the creditor proved a transfer in trust was "intended in whole or in part, to hinder, delay, or defraud."¹¹ Unfortunately, that open language gave creditors a huge arsenal with which to attack a trust.


By its very nature, a self-settled trust is meant "to hinder or delay" a creditor. The term "hinder or delay" is contained in Section 4 of the Uniform Fraudulent Transfer Act that has been


adopted by Delaware, Nevada, Rhode Island and Utah.¹² The problem created by the phrase "hinder or delay" surfaced in the recent Wyoming case of *Breitenstine v. Breitenstine*.¹³ In that case, the state Supreme Court said: "Our case law indicates that an 'intent to hinder or delay creditors' is enough to consider

the conveyance fraudulent even if there was no actual fraud."

Alaska has solved this problem by deleting the two phrases "in whole or in part" and "hinder or delay" from its statute. A settlor's transfer of property in trust can now be set aside only if a creditor can prove the transfer was made with an

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"intent to defraud that creditor."

- **NEW AFFIDAVIT REQUIREMENT.** It is common practice for an attorney to require an affidavit from a settlor of a self-settled trust stating the conveyance is not fraudulent as to any creditor. Alaska now requires the settlor to sign a sworn affidavit containing specific provisions before the settlor transfers assets to the trust.³³ As a result, the chance of a fraudulent conveyance has been reduced; the affidavit also provides additional protection to the attorney who drafts the trust.
- **PROTECTION OF CRTS, INCLUDING UNITRUSTS WITH NON-CHARITABLE REMAINDER BENEFICIARIES.** Various other provisions in the new Alaska law duplicate provisions of Delaware's Qualified Dispositions in Trust Act. The most important of these allow a settlor to protect an annuity or unitrust interest that has been retained in a charitable remainder trust.³⁴ In addition, a settlor may create a self-settled trust and protect the retention of a unitrust interest, provided the unitrust amount does not exceed the maximum that may be stated as income under Alaska's newly amended Principal and Income Act or under IRC Section 643(b).³⁵
- **PRESERVATION OF A DISTINCTION IN ALASKA LAW.** What remains unchanged is a very important distinction contained in Alaska law that is not found in the self-settled trust legislation of Delaware and Utah. In Alaska, no creditor of the settlor (not a child support agency, a spouse, nor an ex-spouse) is able to reach any of the trust assets.³⁶ Completed gift treatment is dependent upon a determination that no creditor is able to satisfy its claim out of the trust assets. Herein lies the ability of a settlor in an Alaskan self-settled trust to make a completed gift that is not theoretically possible in Delaware or Utah. In

each of those other states, specified creditors who come into existence after the trust is established can have their claims satisfied out of the trust.³⁷ Because a transfer of assets in a self-settled trust in those states must be viewed as an incomplete gift, the trust assets are still part of, and thus must be included in, the settlor's gross estate.³⁸

Admittedly, Alaska requires that a settlor cannot be delinquent in a child support obligation when the trust is settled. The status of these obligations, however, can be determined easily when the trust is settled. As the new Alaska law made its way through the legislative process, the Child Support Enforcement Division wanted a child-support exception for claims that arose after the trust was settled. Ultimately the legislature agreed that the ability of a settlor to make a completed gift was an important attribute to maintain, and that spendthrift protection should be effective against all creditors who arise subsequent to the establishment of the trust.

STAY TUNED

Preserving wealth during life and moving it forward in a manner that can benefit future generations should be the goal of every estate planner. As reflected by the new trust law, Alaska is in the vanguard of a growing list of states that has embraced these dual objectives. The question remains: What will Alaska do next? ■

Endnotes

1. The bill may be found at <http://www.legis.state.ak.us/pdf/23/Bills/HB0212B.PDF>.
2. *Restatement Second, Conflict of Laws* Section 273.
3. The spendthrift statute applies equally to third-party beneficiary trusts and self-settled trusts, see AS 34.40.110 (a), (h).
4. *Ibid.*
5. AS 34.40.110(c).
6. *Restatement Third, Trusts* Section 60, cmt g.
7. *Ibid.*
8. AS 34.40.110(h).
9. Treas. Reg. 20-2041-1(c).
10. AS 13.36.035(c).
11. AS 34.40.115. Rhode Island has a similar statute, see R.I. Gen. Laws Section 34-22-13.
12. *Restatement, Property Second, Donative Transfers* Section 13.2 (1986).
13. *Ibid.*
14. *Ibid.* Sections 13.4, 13.5, see AS 34.40.115.
15. *Restatement Third, Trusts* Section 5B, cmt. f(1), ex. 11. The concept of ownership in the *Restatement Third, Trusts*, is in contrast to the *Restatement Second Property: Donative Transfers* Section 13.2 (1986).
16. AS 34.40.110(a).
17. AS 13.3C 370.
18. See Del. Code Ann. title 12 Section 3572 (b)(1); NRS Section 166.170; Rhode Island Gen Laws Section 18-9.2-4 (b); Utah Code Ann. Section 25-6-14 (4)(a).
19. AS 34.40.110(d).
20. Del. Code Ann. title 6 Section 1304(a)(1); NRS 112.180(1)(a); Rhode Island Gen. Laws Section 6-16-4 (a)(1); Utah Code Ann. Section 25-6-14(2)(c)(i).
21. 2003 WY 16, 62 P.3d 587, paragraph 18 (Wyo. Jan. 30, 2003).
22. AS 34.40.110(k), which has prospective application only.
23. AS 34.40.110(b).
24. AS 34.40.110(b).
25. See PLR 9837007, Treas. Reg. 25.2511-2; Rev. Rul. 76-103, 1976-1 C.B. 293; *Paolozzi v. Commissioner*, 23 T.C. 182 (1954); *Commissioner v. Vander Weele*, 254 F.2d 895 (6th Cir. 1958); *Estate of German v. United States*, 7 Cl. Ct. 641 (1985).
26. Del. Code Ann. title 12 § 3573 (2) allows trust assets to be attached to satisfy a claim for child support or alimony. Utah Code Ann. Section 25-6-14(2)(c)(vii) allows trust assets to be attached in satisfaction of a claim or tax of the state or its political subdivisions.
27. An argument has been advanced by Richard W. Nenno and W. Donald Sparks, II, in Schurig and Osborne, *Asset Protection: Domestic and International Law and Tactics* (West Group, 1995), Section 14A:126 which claims the statutorily authorized exceptions in Delaware law are "acts of independent significance" which do not produce an adverse transfer tax result.

HOUSE COMMITTEE REPORT

(7)

Date Referred to Committee: March 26, 2003

FURTHER REFERRALS: Finance

Date of Committee Action: April 4, 2003

The JUDICIARY Committee considered:

HB 212

HOUSE BILL NO. 212

POWERS OF APPOINTMENTS/TRUSTS/CREDITORS

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditors' claims against property subject to a power of appointment."



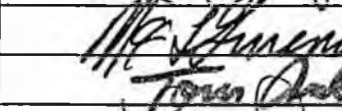
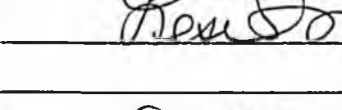
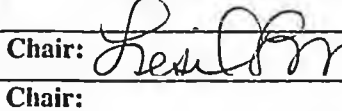

Recommends it be replaced with [] HCS or [] CS for HB 212 (JUD)
 For Senate Bills with new title: [] Technical Title [] New Title: HCR _____ [] Same Title [] New Title

- [] attach amendments
- [] add new referral to _____ Committee
- [] Letter of Intent _____ Committee

List of Abbrev for Depts.:
 ADM
 CED
 COR
 CRT
 EED
 DEC
 DFG
 GOV
 HSS
 LEG
 LAW
 LWF
 MVA
 DNR
 DPS
 REV
 DOT
 UA

<u>NEW FISCAL NOTES</u>				
<small>*Assigned by Chief Clerk's Office</small>				
List by Dept(s):	*FN#	Fiscal	Indet.	Zero
<u>LAW</u>				✓

<u>PREVIOUS FISCAL NOTES</u>				
List by Dept(s):	FN#	Fiscal	Indet.	Zero

<u>Signing with recommendations</u>	Printed Last Name	DP	DNP	NR	AM
	SAMUELS			✓	
	Holm			✓	
	Gara	✓			
	O'g	✓			
	Greenberg	✓			
	Anderson	✓			
	McBride	✓			
Chair:		✓			
Chair:					

Alaska State Legislature

Session
State Capitol Building, Room 118
Juneau, Alaska 99801-1182
Phone (907) 465-2995
Fax (907) 465-6592

Interim
716 West Fourth Avenue, Suite 430
Anchorage, Alaska 99501
Phone (907) 269-0250
Fax 9907) 269-0249



Chair, Judiciary Committee
Vice-Chair, House Committee on
Economic Development,
Trade and Tourism

Member
Oil & Gas Committee

Representative Lesil McGuire

House District 28

Sponsor Statement

HB 212

“An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor’ claims against, property subject to a power of appointment.”

Alaska was once in the lead in development of trust law. However, since that time other states have not only enacted similar legislation but have improved on it. Delaware has amended its statute six times since the date of enactment. The last time we amended our trust statutes and in particular our spendthrift statute was in 1998 and as a result, our laws are viewed as being deficient in many respects. This not only places our trust companies in an uncompetitive position but also places Alaska residents at a disadvantage when compared to the citizens of our competitor states. This bill rectifies many of these shortcomings.

This bill provides statutory authority to provisions commonly found in trust instruments. For instance, Section 1 of the bill specifically provides for the position of a trust advisor and trust protector and clarifies the manner in which these positions relate to the administrations of a trust. Delaware, South Dakota, and Idaho has similar legislation. Many trust instruments allow a trustee to make trust assets available for the use of a beneficiary. Section 2 allows trusts assets consisting of real property and tangible personal property to be used by a beneficiary without the use being considered a distribution which could in turn be subjected to the claims of a beneficiary’s creditors. For example, a trustee could exercise its discretion and permit a beneficiary to reside in a family home. Were it not for this provision, the settlor’s intention that a family homestead be made available for future generations might be defeated.

Other sections contained in the bill codify a number of matters which have always been accepted by Alaska trust practitioners as being the common law of this state, but for which there has been no statutory counterpart. Section 4 provides that trust assets can not be attached by a beneficiary’s creditor until such time that trust assets are actually distributed to a beneficiary, nor can there be a continuing order against the trustee with respect to future distributions that a trustee would choose to make. Section 6 adds a new subsection (i) to AS 34.30.110, which clarifies that the statute affording spendthrift protection for beneficial interests applies not only to trusts in which a settlor may have a

retained interest, but also to the very common third party settled trust where a beneficiary might be serving as sole trustee.

Sections 3, 5, and 6 make amendments or add subsections to AS 34.40.110, which will assist a future court in the interpretation of our spendthrift statute, something an Alaska court has yet to do. Section 3 clarifies that a trust can be set aside only if a creditor is able to successfully assert by a preponderance of the evidence that the settlor's transfer of property in trust was made with the primary intent to defraud that creditor. In so doing, the finder of fact must weight all the circumstances surrounding the transfer before making that determination. Section 5 clarifies that a fraudulent conveyance action may only be brought against a settlor of a trust and then only as to a specific transfer of assets that are determined to be fraudulent as to that creditor. Section 5 also clarifies the definition of preexisting creditors who can avail themselves during the time period found in AS 34.40.110(d)(1) by bringing a fraudulent conveyance action against the settlor of a self-settled trust. Subsection (h) as found in Section 6 provides a transfer restriction will be valid with respect to a beneficial interest retained by a settlor even though the settlor serves as a co-trustee, provided the settlor doesn't have control over the manner in which distributions may be made to the settlor. Subsection (k) invalidates any unwritten agreement or understanding between a settlor who is a beneficiary and a trustee that gives the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Lastly, there are several provisions contained in this bill that have their counterpart in the laws of other states. Section 3 provides the circumstances in which a transfer restriction will continue to be valid even though a settlor retains a unitrust or annuity interest in the trust. These provisions presently exist in Delaware. Section 7 of the bill clarifies when property subject to a power of appointment can be subjected to the claims of a donee's creditors and codifies the common law as enunciated in the Restatement 2nd of Property and has its genesis in a comparable Rhode Island statute. All the provisions found in this bill are necessary additions not only if Alaska expects our trust industry to remain competitive with other states, but also if Alaska residents are to have the benefits comparable to those of citizens in other states.

Alaska State Legislature

Session
State Capitol Building, Room 118
Juneau, Alaska 99801-1182
Phone (907) 465-2995
Fax (907) 465-6592

Interim
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Phone (907) 269-0250
Fax (907) 269-0249



Chair, Judiciary Committee
Vice-Chair, House Committee on
Economic Development,
Trade and Tourism
Member
Oil & Gas Committee

Representative Lesil McGuire

House District 28

Sectional Analysis HB 212

“An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor’ claims against, property subject to a power of appointment.”

Section 1:

AS 13.36.370 adds a new provision commonly found in trust instruments concerning the role of the disinterested trust protector. South Dakota, Delaware, and Idaho also have a statutory framework delineating a trust protector’s authority. It is fully within the settlor’s discretion as to whether or not there will be a trust protector. If a settlor does not want a trust protector there will be no trust protector. Furthermore, a trust protector will only have those powers that the settlor grants the trust protector. An irrevocable trust containing a trust protector provision provides flexibility to take into account changed circumstances.

For instance, suppose a settlor creates a trust for the benefit of a child and names a friend to act as trustee. Subsequently it is discovered that the trustee is not using the trust assets for the benefit of the beneficiary in the manner in which the settlor had originally intended. Unless the trustee voluntarily resigns, it could require an expensive court proceeding to remove and replace the trustee. However, if there is a trust protector who has the authority to remove and replace an existing trustee, the trustee could be replaced without the necessity of a court proceeding. Another example of where a trust protector might be valuable is when there is an unforeseen change in tax laws. For instance, if the estate tax is permanently repealed, certain provisions of existing trusts might be unnecessary or undesirable. If the settlor so provided, a trust protector could amend the trust and eliminate an otherwise undesirable provision in the trust.

Notwithstanding the foregoing, a trust protector is not permitted to change the beneficial interest of the State in a Miller trust.

In addition, AS 13.36.375 adds a new provision commonly found in trust instruments concerning the role of a trustee advisor. This provision is commonly found where a settlor appoints an institution as the trustee to handle the investing and administrative functions but wants to appoint a family friend, who is aware of the beneficiary’s needs, to advise the trustee when trust distributions may or may not be appropriate. This section states the advisor will not be held accountable as a trustee for rendering or failing to render advice to the trustee.

Section 2:

A "use" provision is commonly found in trust instruments and allows a trustee to make trust assets available for the use of a beneficiary. This section amends AS 34.40.110(a) by stating that property may be made available for the use of a beneficiary without the use being considered a distribution that could possibly expose the trust assets to the claims of a beneficiary's creditors. Furthermore, the original owner can be assured that important family assets such as heirlooms and a vacation home may be maintained by the family and that their use can be made available for future generations.

Section 3:

AS 34.30.110(b)(1) is amended to provide that a transfer restriction can be disregarded only if a creditor proves by a preponderance of the evidence that the settlor's primary intent in making the transfer was to defraud the settlor's creditors. This section eliminates ambiguous language such as "hinder and delay." It also eliminates meaningless language such as "other persons," which is meaningless in the sense that the only class of persons who could possibly be defrauded by a settlor transferring property into trust is creditors of that settlor.

This section was also amended to clarify that it must be first determined that the primary intent of the settlor in creating a trust was to defraud a creditor before the transfer in trust can be set aside as a fraudulent conveyance. Adding the word "primary" to this section provides judicial guidance heretofore missing. Because a settlor will rarely admit to actually intending to defraud a creditor, courts typically consider factual circumstances constituting "badges of fraud" to infer fraud. For instance, a transfer to an insider (as would be the case of any gift to a family member) is considered a badge of fraud under Section 4(b) of the Uniform Fraudulent Transfer Act. Unfortunately, this might be enough for a court to infer fraud. This lack of statutory guidance could lead to a very arbitrary and capricious finding that the mere existence of a singular "badge of fraud" renders the entire transfer fraudulent. The use of the word "primary" make it necessary for the finder of fact to weight all the circumstances surround the transfer. Only if a creditor is able to prove by a preponderance of the evidence that the primary intent of the settlor was to defraud that creditor can the transfer in trust be set aside.

AS 34.40.110(b)(3) is amended to provide a transfer restriction will continue to be valid with respect to an annuity or unitrust interest retained by a settlor provided the remainder interest is given to a public charity. In addition, a settlor may also retain an annuity or unitrust interest irrespective of whether the remainder interest is designated to charity provided the annuity or unitrust interest does not exceed the amount set forth as "income" under the Alaska Principal and Income Act or under the Internal Revenue Code. A similar statute is found in Delaware.

Section 4:

AS 34.40.110(c) is amended to provide that a creditor of a beneficiary may not attach trust assets while the assets remain in trust if the beneficial interest is subject to a valid transfer restriction. In addition, this provision is meant to assure the settlor that trust assets can not be subjected to the claims of a beneficiary's creditor until such time that trust assets have actually been distributed to the beneficiary. Furthermore, this section provides that no attachment or other order may be made against a trustee by a creditor with respect to a beneficial interest which

might compel the trustee to make a future distribution to a creditor in lieu of making a distribution directly to the beneficiary.

Section 5:

This section clarifies that only a creditor of a settlor can bring a fraudulent conveyance action with regard to a transfer of assets to a trust and only in regard to a specific transfer of assets by a settlor to the trust. A third party beneficiary's creditor can not set aside a transfer when the property was originally that of a settlor and not that of the third party beneficiary. On the other hand, where the settlor is retained as a beneficiary under the terms of the trust, a creditor can bring a fraudulent conveyance action because in this case the settlor is also a beneficiary.

AS 34.40.110(d) sets forth a prescribed period of time in which a fraudulent conveyance action must be brought depending on whether the creditor is a preexisting creditor or a subsequent creditor.

A preexisting creditor (i.e., a creditor who was in existence prior to the settlor transferring property in trust) must bring the fraudulent conveyance action within the later of four years after the transfer of a settlor's assets is made or one year after the transfer is or reasonably could have been discovered by the creditor. A subsequent creditor must bring the fraudulent conveyance within four years after the transfer of a settlor's assets is made.

A preexisting creditor has what is essentially an unlimited statute of limitations period to bring a fraudulent conveyance action because it can be brought within one year after the transfer is or reasonably could have been discovered. A creditor might not reasonably discover the transfer in trust until such time that the creditor has first reduced the action to judgment and conducted a judgment debtor examination. The problem with the statute as it now stands is that the term "preexisting creditor" is not defined. Consider a doctor who performs an operation and thinks all went well with the operation, engages in estate planning and transfers property in trust. At a later point in time the patient has complications and asserts that the doctor was negligent. Should this patient be considered a "preexisting creditor" even though the patient never asserted a claim against the doctor prior to the doctor transferring assets to the trust? What about the engineer or architect who builds a bridge which falls down 20 years later. Is the plaintiff to be considered a "preexisting creditor"? If so, then no one who has been in business for any length of time could ever safely create a trust or otherwise engage in estate planning without risking the possibility that a transfer in trust might later be set aside, even though the "preexisting creditor" might be unknown to the settlor. Nonetheless, there comes a point in time when every doctor and every engineer should be able to arrange their estate planning affairs like anyone else and have the assurance that at some point in time it will not be undone. This bill attempts to provide that assurance but does so in a manner that balances the legitimate rights of the settlor's creditors.

Thus, it is important that the statute define a "preexisting creditor." A "preexisting creditor" is defined as one who either

- (1) demonstrates, by a preponderance of the evidence, that they asserted a specific claim against the settlor before the settlor transferred assets to the trust; or

- (2) within four years after the settlor transferred assets to the trust, files an action in court against the settlor which asserts a specific cause of action based on an act or omission of the settlor that occurred before the transfer of assets to the trust.

Section 6:

This section adds a number of sections to existing law that clarify that an otherwise valid transfer restriction will not be invalidated even though:

(h) a settlor who is also a beneficiary is serving as a co-trustee or advisor to the trustee provided the settlor does not have a trustee power over discretionary distributions;

(i) a beneficiary of a third party settled trust is serving as sole trustee of the trust, a co-trustee or as an advisor to the trustee; or

(j) a settlor is given the authority to appoint a trust protector or a trust advisor.

Subsection (k) invalidates any unwritten agreement or understanding between a settlor, who is being retained as a beneficiary, and the trustee, which attempts to give the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Section 7:

This section codifies the common law as now found and enunciated in the Restatement 2nd of Property, by adding a new section AS 34.40.115. This section states that assets subject to a power of appointment, whether a non-general power of appointment or a presently exercisable or testamentary general power of appointment, cannot be subjected to the claims of the donee's (holder's) creditors. The legal theory behind this statute is that until the donee exercises the power, the donee has not accepted control over the appointive assets that give the donee the equivalent of ownership. This statute provides that only until a testamentary or a presently exercisable general power of appointment is actually exercised, can the appointive assets be subjected to the payment of claims which a creditor might have against the donee of the power of appointment. This statute is taken from a similar statute in Rhode Island.

Section 8:

This section contains the effective dates.

HOMPESCH & EVANS

ATTORNEYS AT LAW
A PROFESSIONAL CORPORATION
119 N. CUSHMAN STREET, SUITE 400
FAIRBANKS, ALASKA 99701-2879

TELEPHONE
(907)452-1700
FACSIMILE
(907)456-5693
EMAIL:
hompesch@hompesch.com

RICHARD W. HOMPESCH II
SUSAN L. EVANS

PROFESSIONAL STAFF
BARBARA CORY-HOMPESCH
ENROLLED AGENT (IRS)

March 30, 2003

VIA E-MAIL AND FAX

Representative Lesil McGuire
Juneau, Alaska

Re: The Trust Bill

Dear Representative McGuire:

I am writing with regard to the Trust Bill. As you know, the bill amends both AS 13.36 and AS 34.40. I am in favor of both amendments. My reasons are as follows:

Amendment to AS 13.36. I favor codifying the positions and listed powers of trust protectors and trust advisors because of the flexibility they add to trusts. If there is no built-in flexibility the beneficiaries and trustees inevitably end up in court grappling with issues unforeseen at the time the trust was created. I also favor the default rule that neither the trust protector nor trust advisor have fiduciary duty. Clients often name close family friends and advisors as trust protectors and trust advisors, recognizing that they would not be able to serve if they were held to the highest (fiduciary) standard of care.

Amendment to AS 34.40. I favor the amendments to AS 34.40 because they bring much-needed clarification to the section.

I am grateful for your attention to this matter.

Sincerely yours,

HOMPESCH & EVANS
A Professional Corporation

Susan L. Evans

SLE/

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 212
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Law
 Title "An Act relating to trusts, including trust BRU Civil Division
protectors, trustee advisors, transfers of property in trust, . . ." Component Commercial
 Sponsor Representative McGuire
 Requester House Labor and Commerce Committee Component No. 2211

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type-Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*
 HB 212 provides for the appointment of a trust protector and a trust advisor. The bill also prevents creditors of beneficiaries from attaching assets transferred into a trust unless certain conditions are met by all parties, and establishes a statute of limitations regarding when creditors must bring an action for a fraudulent transfer claim.

 Passage of this legislation will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson Phone (907) 465-5370
 Division Attorney General's Office Date/Time 3/28/03 2:45 PM
 Approved by: Joan M. Kasson for Gregg D. Renkes, Attorney General Date 3/28/2003
 Agency Department of Law

HB

214

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 214
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Law
 Title "An Act relating to the recovery of punitive BRU Civil Division
damages against an employer . . ." Component Governmental Affairs
 Sponsor Representative Samuels Special Litigation
 Requester House Judiciary Component No. 2207; 2213

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type—Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill would limit when an employer who is held liable in a civil action for an act or omission of an employee could be required to pay punitive damages.

The State of Alaska as an employer is immune from punitive damages under AS 09.50.280. This bill will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson Phone (907) 465-5370
 Division Attorney General's Office Date/Time 3/28/03 2:45 PM
 Approved by: Joan M. Kasson for Gregg D. Renkes, Attorney General Date 3/28/2003
 Agency Department of Law

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 214
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: _____
 Title Punitive damages against employers BRU Alaska Court System
 Component Trial Courts
 Sponsor Representative Samuels
 Requester House Judiciary Component No. 768

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type-Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

The court system does not anticipate any fiscal impact from the passage of HB 214.

Prepared by: Douglas Wooliver, Administrative Attorney Phone 463-4750
 Division: Alaska Court System Date/Time 3/28/03 10:27 AM
 Approved by: Stephanie Cole, Administrative Director Date 3/28/2003
 Agency: Alaska Court System

ALASKA STATE LEGISLATURE

Rep. Lesil McGuire, Chair
Rep. Tom Anderson, Vice-Chair
Rep. John Coghill
Rep. Jim Holm
Rep. Ralph Samuels
Rep. Les Gara
Rep. Max Gruenberg



State Capitol, Room 120
Juneau, AK 99801-1182
(907) 465-4990
Fax (907) 465-6592

House Judiciary Committee

Memorandum

To: Mike Ford, Leg. Legal
From: Vanessa Tondini, Committee Aide
House Judiciary Committee
Date: April 2, 2003
Re: CS Request

Please create a final draft House Judiciary Committee Substitute for work order # 23-LS0833\H, HB 214: Punitive Damages Against Employers, incorporating the changes which I have written into the attached bill. The bill was passed out of committee today.

If you have any questions, please call me at 4990. Thank you!

The information attached to this memo is **CONFIDENTIAL** an/or privileged. It is intended to be reviewed initially by only the individual named above. If the reader of this Memorandum is not the intended recipient or a representative of the intended recipient, you are hereby notified that any review, dissemination, or copying of the information contained herein is prohibited. If you have received this in error, please immediately notify the sender by telephone and return this to the sender at the above address.

HOUSE BILL NO. 214

**IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION**

BY REPRESENTATIVES SAMUELS, Holm, Rokeberg, Meyer, McGuire, Hawker

Introduced: 3/26/03

Referred: Judiciary

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the recovery of punitive damages against an employer who is
2 determined to be vicariously liable for the act or omission of an employee; and providing
3 for an effective date."

4 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

5 * Section 1. AS 09.17.020 is amended by adding a new subsection to read:

6 (k) In a civil action in which an employer is determined to be vicariously
7 liable for the act or omission of an employee, punitive damages may not be awarded
8 against the employer under principles of vicarious liability unless

9 (1) the employer

10 (A) authorized the act or omission and the manner in which the
11 act was performed or omission occurred; or

12 (B) ratified or approved the act or omission after the act or
13 omission occurred; or

14 (2) the employee

1 (A) was unfit to perform the act or avoid the omission and the
2 employer acted recklessly in employing ^{or retaining} the employee; or

3 (B) was a managing officer or a director of the employer.

4 * Sec. 2. The uncodified law of the State of Alaska is amended by adding a new section to
5 read:

6 APPLICABILITY. This Act applies to a cause of action that accrues on or after the
7 effective date of this Act.

8 * Sec. 3. This Act takes effect July 1, 2003.

AMENDMENT 2

- Adopted.

By: Representative Gara

Page 2, line 2. After "employing"

Insert: "~~supervising~~ or retaining"

Amend #3, P.2, L.2 - Failed
Add "grossly negligent"

AMENDMENT 1 - FAILS

By: Representative Gara

Page 2, line 2. After "acted"

Delete: "recklessly"

Insert: "negligently"

AMENDMENT 2

Withdrawn

By: Representative Gara

Page 2, line 1: After "omission"

Delete: "and"

Insert: "or"

REST 2d TORTS S 909
Restatement (Second) of Torts § 909 (1979)

Restatement of the Law -- Torts
Restatement of the Law Second -- Torts
Current through June 2002

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Division 13. Remedies
Chapter 47. Damages
Topic 1. General Statements

§ 909. Punitive Damages Against A Principal

Link to Case Citations

Punitive damages can properly be awarded against a master or other principal because of an act by an agent if, but only if,

- (a) the principal or a managerial agent authorized the doing and the manner of the act, or
- (b) the agent was unfit and the principal or a managerial agent was reckless in employing or retaining him, or
- (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or
- (d) the principal or a managerial agent of the principal ratified or approved the act.

Comment:

a. This Section is duplicated by § 217C of the Restatement, Second, of Agency, which refers to this Section for comment and illustrations.

b. The rule stated in this Section results from the reasons for awarding punitive damages, which make it improper ordinarily to award punitive damages against one who himself is personally innocent and therefore liable only vicariously. It is, however, within the general spirit of the rule to make liable an employer who has recklessly employed or retained a servant or employee who was known to be vicious, if the harm resulted from that characteristic. (See Illustration 1). Nor is it unjust that a person on whose account another has acted should be responsible for an outrageous act for which he otherwise would not be if, with full knowledge of the act and the way in which it was done, he ratifies it, or, in cases in which he would be liable for the act but not subject to punitive damages, he expresses approval of it. (See Illustration 2). In these cases, punitive damages are granted primarily because of the principal's own wrongful conduct.

Although there has been no fault on the part of a corporation or other employer, if a person acting in a managerial capacity either does an outrageous act or approves of the act by a subordinate, the imposition of punitive damages upon the employer serves as a deterrent to the employment of unfit persons for important positions. (See Illustration 3).

Illustrations:

1. A employs an ejection company to dispossess a tenant. A knows that the company has a reputation for using undue force in dealing with tenants. An employee of the company, in accordance with its usual methods, commits an unprovoked battery upon B, the wife of the tenant, in order to induce her to leave. In an action by B against A, punitive damages can properly be awarded.
2. A, the owner of a theatre, employs a special policeman to keep order. In ejecting a small boy from the theatre, the policeman cruelly abuses him. Upon learning the facts, A expresses his approval. Punitive damages can properly be awarded against A in an action for the battery.
3. A, a corporation owning a series of retail stores, employs B as operations manager to supervise the management of the units. While visiting a unit B discovers facts

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that lead him to believe erroneously that one of the clerks has been stealing. He directs the local manager to imprison the clerk. In the ensuing interview he permits the local manager to use outrageous means of intimidation. In the clerk's action against the corporation, punitive damages can properly be awarded.

LEXSEE 970 p.2d 906

**VECO, INC., Appellant and Cross-Appellee, v. CONSTANCE I. ROSEBROCK,
Appellee and Cross-Appellant.**

Supreme Court Nos. S-7080, S-7120, No. 5084

SUPREME COURT OF ALASKA

970 P.2d 906; 1999 Alas. LEXIS 24

February 19, 1999, Decided

PRIOR HISTORY:

[**1] Appeal from the Superior Court of the State of Alaska, Third Judicial District, Anchorage, Joan M. Woodward, Judge. Superior Court No. 3AN-92-10614 CI.

This Opinion of Substituted by the Court for Withdrawn Opinion of December 18, 1998, Previously Reported at: 1998 Alas. LEXIS 173.

DISPOSITION:

AFFIRMED AND REVERSED.

CASE SUMMARY

PROCEDURAL POSTURE: Appellant employer sought review of a decision from the Superior Court of the State of Alaska, Third Judicial District, Anchorage, awarding judgment to appellee employee in her sexual harassment and wrongful termination claims.

OVERVIEW: Plaintiff employee was subjected to sexual harassment arising to the level of a hostile work environment from her direct supervisor and another employee. Plaintiff complained to another of her supervisors and then went on a scheduled leave. Prior to her return to work, however, she was informed that she was laid off. Plaintiff sued and won a judgment including punitive damages. Defendant employer appealed and argued that punitive damages could not be awarded for acts of a supervisor outside the scope of the supervisor's employment. The court agreed, reversing the judgment as it pertained to the awarding of punitive damages. However, the court upheld the judgment in all other aspects and specifically remanded the issue of punitive damages for a new trial to determine whether punitive damages should have been awarded.

OUTCOME: Judgment for plaintiff was affirmed as to compensatory damages, but reversed and remanded for a new trial for a determination whether punitive damages could be assessed against defendant employer for the actions of its employee done outside the scope of employment.

CORE TERMS: supervisor, sexual harassment, punitive damages, wrongful termination, harassment, hostile, vicarious liability, severe, hostile work environment, pervasive, vicariously liable, sexual assault, new trial, retaliation, mixed-motive, supervisory, terminating, termination, remedial action, managerial, servant, pretext, scope of employment, employment decision, motive, employer liability, discriminatory, management-level, terminated, subjected

Labor & Employment Law > Discrimination > Title VII

[HN1] A section of Alaska's anti-discrimination statute makes it unlawful for an employer to discriminate against a person in compensation or in a term, condition, or privilege of employment because of the person's sex when the reasonable demands of the position do not require distinction on the basis of sex. *Alaska Stat. § 18.80.220(a)(1)*. This section prohibits sexual harassment.

Labor & Employment Law > Discrimination > Sexual Harassment > Quid Pro Quo

[HN2] Quid pro quo gender harassment occurs when an employer conditions employment benefits on sexual favors. It arises when an employer relies upon his or her authority to extort sexual consideration from an employee.

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN3] In hostile work environment cases, employees work in offensive or abusive environments. Conduct which unreasonably interferes with work performance can alter a condition of employment and create an abusive working environment. Discriminatory behavior sufficiently severe or pervasive to alter the conditions of the victim's employment and to create a discriminatory hostile work environment violates *Alaska Stat. § 18.80.220*.

Labor & Employment Law > Discrimination > Sexual Harassment > Quid Pro Quo

[HN4] Quid pro quo harassment requires proof that a tangible employment action resulted from a refusal to submit to a supervisor's sexual demand.

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN5] Unfulfilled threats or offensive conduct in general may fall within the hostile work environment classification.

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN6] Often a hostile work environment is created by co-employees or supervisors acting beyond the scope of their employment. They are acting for personal reasons and not, even in part, to serve their employer. However, in the case of supervisors, harassment, though beyond the scope of their employment, may be facilitated by their position with the employer.

Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment

[HN7] Scope of employment is defined as follows: Conduct of a servant is within the scope of employment if, but only if: it is of the kind he is employed to perform; it occurs substantially within the authorized time and space limits; it is actuated, at least in part, by a purpose to serve the master, and if force is intentionally used by the servant against another, the use of force is not unexpected by the master. Conduct of a servant is not within the scope of employment if it is different in kind from that authorized, far beyond the authorized time or space limits, or too little actuated by a purpose to serve the master.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability***Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment***

[HN8] An employer is generally vicariously liable only for acts of employees acting within the scope of their employment. However, vicarious liability may also be imposed based on apparent authority or where an employee is aided in accomplishing a tort by the employee's position with the employer. But an employer's vicarious liability for punitive damages is limited to acts of managerial employees while acting within the scope of their employment. Alaska case law has eliminated the requirement that the employees be managerial, but not the requirement that their acts be within the scope of their employment.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability***Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment***

[HN9] A master is subject to liability for the torts of his servants committed while acting in the scope of their employment. A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless: the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.

Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment***Torts > Damages > Punitive Damages***

[HN10] Punitive damages can properly be awarded against a master or other principal because of an act by an agent if, but only if, the principal authorized the doing and the manner of the act, or the agent was unfit and the principal was reckless in employing him, or the agent was employed in a managerial capacity and was acting in the scope of employment, or the principal or a managerial agent of the principal ratified or approved the act.

Civil Procedure > Jury Trials > Jury Instructions

[HN11] Jury instructions involve questions of law, which this court reviews using its independent judgment. An erroneous statement of law in jury instructions will not be reversed unless prejudice is shown.

Labor & Employment Law > Discrimination > Disparate Treatment

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN12] Title VII of the Civil Rights Act of 1964 makes it an unlawful employment practice for an employer to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin. 42 U.S.C.S. § 2000e-2(a) (1). The United States Supreme Court held that Title VII prohibits hostile environment sexual harassment.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN13] Harassment by supervisors is facilitated, made more serious, and is less apt to be reported because supervisors are understood to be clothed with the employer's authority.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN14] Even where the employer has issued a policy prohibiting sexual harassment, and where the employer has established procedures for the receipt of employee complaints, the employer will still have aided the supervisor in committing the harassment. Therefore, an employer is vicariously liable for the hostile work environment created by its supervisors regardless of whether management-level employees knew or should have known about the harassment, and regardless of whether the supervisors were acting within the scope of their employment.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN15] An employer will only be vicariously liable for the acts of the complainant's supervisor, because only then will the supervisor be using his position with the employer to alter the conditions of the complainant's employment. A supervisor who does not oversee the complainant should be treated as a co-worker. In that situation, the supervisor does not have authority over the complainant and may not be aided by his position in the workplace. Furthermore, when a co-worker or supervisor with no control over the complainant creates a hostile environment, the complainant should be less hesitant to report the situation, since the harasser could not retaliate by changing the conditions of the complainant's employment. Thus, employers are only vicariously liable for hostile environment sexual harassment committed by the complainant's supervisor.

Labor & Employment Law > Employer Liability > Tort Liability > Direct & Vicarious Liability

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN16] There is no basis for distinguishing between supervisors' acts of harassment and their failure to remedy known harassment. Supervisors who allow other employees to sexually harass employees they supervise have used their delegated authority to allow the harassment to continue.

Civil Procedure > Trials > Judgment as Matter of Law

[HN17] When reviewing a motion for a judgment notwithstanding the verdict, the court determines whether evidence, when viewed in the light most favorable to the non-movant, is such that reasonable persons could not differ in their judgment. The court neither weighs the evidence nor judges the credibility of witnesses. Rather, it employs an objective test: If there is room for diversity of opinion among reasonable people, then a jury question exists.

Civil Procedure > Relief From Judgment > Motions for New Trial

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

[HN18] The court reviews the superior court's denial of a motion for a new trial for an abuse of discretion. An abuse of discretion occurs only if the evidence supporting the jury's verdict was either completely lacking or slight and unconvincing, so that the verdict was manifestly unreasonable and unjust. The court will draw all inferences from the facts in the light most favorable to the non-movant.

***Governments > Legislation > Interpretation
Civil Procedure > Jury Trials > Province of Court & Jury***

[HN19] Statutory interpretation is a question of law which this court reviews using its independent judgment.

Torts > Damages > Compensatory Damages

[HN20] *Alaska Stat. § 22.10.020(i)* authorizes a court finding a violation of any of the provisions of *Alaska Stat. § 18.80* to award any other relief including the payment of money, that is appropriate. This includes an award of compensatory damages.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings

[HN21] The superior court is accorded wide discretion in ruling on motions to amend pleadings.

Labor & Employment Law > Wrongful Termination

Labor & Employment Law > Discrimination > Retaliation

[HN22] *Alaska Stat. § 18.80.220(a)(4)* provides that it is an unlawful employment practice for an employer, labor organization, or employment agency to discharge, expel, or otherwise discriminate against a person because the person has opposed any practices forbidden under *Alaska Stat. §§ 18.80.200-18.80.280* or because the person has filed a complaint, testified, or assisted in a proceeding under this chapter.

Labor & Employment Law > Discrimination > Sexual Harassment > Hostile Work Environment

[HN23] In determining whether an employer has violated *Alaska Stat. § 18.80.220* when there is no direct evidence of discriminatory intent, the court has adopted the three-part framework used in Title VII cases. This test also governs actions for retaliatory discharge.

Labor & Employment Law > Discrimination > Retaliation

[HN24] To establish a prima facie case of discriminatory retaliation, a plaintiff must show that: she engaged in an activity protected under Title VII; her employer subjected her to adverse employment action; there was a causal link between the protected activity and the employer's action. Causation may be inferred from the proximity in time between the protected action and the allegedly retaliatory discharge. Once a plaintiff establishes a prima facie case, the burden of production shifts to the employer to articulate a legitimate, non-retaliatory explanation for the action. To satisfy this burden, the employer need only produce admissible evidence which would allow the trier of fact rationally to conclude that the employment decision had not been motivated by discriminatory animus. If the employer successfully rebuts the inference of retaliation that arises from establishment of a prima facie case, then the burden shifts once again to the plaintiff to show that the defendant's proffered explanation is merely a pretext for discrimination.

Labor & Employment Law > Discrimination > Retaliation

[HN25] The question of whether a mixed-motive theory applies to wrongful termination depends on the interpretation of the term "because" in *Alaska Stat. § 18.20.220*. In interpreting Title VII, the United States Supreme Court held that the words "because of sex" mean that gender must be irrelevant to employment decisions. It emphasized that the words "because of" do not mean "solely because of," and held that Title VII prohibited decisions based on a mixture of legitimate and illegitimate considerations. The Court then held that if the plaintiff shows that gender was a motivating part in an employment decision, the defendant may avoid a finding of liability only by proving that it would have made the same decision even if it had not allowed gender to play such a role.

Labor & Employment Law > Discrimination > Retaliation

[HN26] The broad language of *Alaska Stat. § 22.10.020(c)* indicates a legislative intent to authorize an award of compensatory and punitive damages for violations of *Alaska Stat. § 18.80*, in addition to the equitable remedies such as enjoining illegal employment activities and ordering back pay as a form of restitution.

Torts > Damages > Punitive Damages

[HN27] The plain language of *Alaska Stat. § 22.10.020(i)* authorizes the superior court to award any other relief, including the payment of money. Further, punitive damages are recoverable in discrimination cases. Moreover, under the common law, Alaska's superior courts possess the authority to award punitive damages for outrageous conduct. Allowing punitive damages under *Alaska Stat. § 18.80.220* does not reach beyond settled expectations. Punitive damages are authorized under § 18.80.220 and § 22.10.020(i).

Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment

[HN28] When an employee commits a wrongful act which would subject him personally to punitive damages, the essential inquiry must be whether the act was committed while the employee was acting within the scope of his employment. If the employee was acting within the scope of his employment, the corporation will be liable for punitive damages regardless of whether that employee may be classified as menial.

*Labor & Employment Law > Employer Liability > Tort Liability > Scope of Employment
Torts > Damages > Punitive Damages*

[HN29] If an employee is acting outside the scope of his employment, he is not acting in any way to further the goals of the employer. The interest of preventing sexual harassment is served by holding an employer vicariously liable for its supervisors' sexual harassment, regardless of whether they are acting within the scope of their employment, because the employer may be deterred from delegating authority to untrained or incompetent supervisors. However, this does not mean that an innocent employer should be punished by an award of punitive damages when its supervisors are acting outside the scope of their employment. Punitive damages are disfavored and are allowed only within narrow limits.

Civil Procedure > Relief From Judgment > Motions for New Trial

[HN30] When a jury award may be based on any one of several theories, one of which has been erroneously submitted to the jury, a new trial is required.

Civil Procedure > Appeals > Reviewability > Preservation for Review

[HN31] Alaska R. Civ. P. 51(a) provides that no party may assign as error the giving or the failure to give an instruction unless the party objects thereto stating distinctly the matter to which the party objects and the grounds of the objection.

COUNSEL:

Donna C. Willard, Law Offices of Donna C. Willard, Anchorage, for Appellant and Cross-Appellee.

Robert P. Owens, Copeland, Landye, Bennett and Wolf, Anchorage, and Timothy D. Dooley, Anchorage, for Appellee and Cross-Appellant.

JUDGES:

Before: Rabinowitz, Matthews, Eastaugh, and Fabe, Justices. [Compton, Chief Justice, not participating.]

OPINIONBY:

MATTHEWS

OPINION:

[*908] OPINION

MATTHEWS, Justice.

I. INTRODUCTION

Many issues are presented in this sexual harassment and wrongful termination case. The two most important are:

(1) Can an employer be liable for acts of a supervisor [**2] which create a hostile work environment even though the supervisor is acting outside the scope of his employment?

(2) Can punitive damages be imposed for a supervisor's acts outside the scope of his employment?

We answer "yes" to the first question because the supervisor is enabled by his position with the employer to impose unwelcome sexual conduct on the employee. We answer "no" to the second question because it is unfair to punish an employer for acts committed by employees who are in no sense pursuing objectives of the employer.

II. FACTS AND PROCEEDINGS

Constance Rosebrock began working for VECO in Anchorage in April 1991. In September she transferred to Arctic Rentals, a VECO subsidiary located on the North Slope. n1 Rosebrock worked for Arctic Rentals on the North Slope for approximately six weeks, from September 11 until September 26, and from October 3 until October 26. On October 30 or 31 she was notified that she had been laid off.

-----Footnote3-----

n1 VECO admits that Arctic Rentals is merely a division of VECO, and does not argue that it is a separate corporate entity.

-----End Footnotes----- [**3]

Rosebrock claims that during her employment with VECO on the North Slope, Rick Rorick, the supervisor in charge of Arctic Rentals, subjected her to hostile environment sexual harassment. In addition, she claims that she was sexually assaulted by a VECO employee toward the end of her second tour of duty. She claims that VECO wrongfully terminated her when she complained about the assault.

In December 1991 Rosebrock filed a complaint with the Alaska Human Rights Commission. She also filed suit in superior court [*909] against VECO and Bill Dropps, the employee who allegedly sexually assaulted her. After settlement negotiations in which Rosebrock agreed to dismiss Dropps as a party, Rosebrock's claims of hostile environment sexual harassment and wrongful termination proceeded to a jury trial. n2

-----Footnotes-----

n2 While Rosebrock originally alleged both quid pro quo and hostile environment sexual harassment claims, the jury only decided the hostile environment sexual harassment claim.

-----End Footnotes-----

At trial, Rosebrock testified that Rorick had sexually [**4] propositioned her on several occasions. She also testified that Rorick made several explicit comments about the size of her breasts. Furthermore, Rosebrock testified that she, Bobby Clark, and Bill Dropps gathered in Dropps's room on October 23 to watch the World Series game. n3 She testified that when Clark left the room, Dropps grabbed her by her arms and legs and threw her onto the bed. They struggled, and he hit her in the ribs. After more struggling, however, he released her and begged her to not tell anyone.

-----Footnotes-----

n3 Rosebrock testified that Clark was her supervisor when Rorick was not on the slope. Dropps was also a supervisor, but he was not Rosebrock's supervisor and did not have any authority over her.

-----End Footnotes-----

Rosebrock also testified that early the next morning she reported the assault to Clark, who was her supervisor on duty at that time. She also claimed that she showed her bruises to a co-worker, Peggy Gerhardson, who assured her that she and Clark would take care of the problem.

Rosebrock went on leave two [**5] or three days later. She testified that before she left, the administrator, Norm Denison, approved her work schedule for the next five months. On October 30 or 31, however, Denison called her at home to tell her that she had been "laid off." Rosebrock testified that she then called Denison several times to see what

VECO was doing about her complaints of sexual assault. Rosebrock claimed that Denison told her VECO had taken care of the problem. Rosebrock stated that when she asked him what had been done, he told her, "you're gone."

The jury found VECO liable for Rosebrock's hostile environment sexual harassment claim and her wrongful termination claim. It awarded her \$ 27,500 for emotional distress damages, \$ 75,000 for lost wages, and \$ 1,500,000 for punitive damages. VECO then moved for a judgment notwithstanding the verdict, for a new trial, and for a remittitur. The superior court granted a partial remittitur, reducing the award for lost wages to \$ 4,000. It denied VECO's other motions.

VECO appeals this judgment. n4 Rosebrock cross-appeals on discovery sanction issues, in the event this court remands for a new trial.

-----Footnotes-----

n4 Counsel for VECO on appeal did not serve as its trial counsel.

-----End Footnotes----- [**6]

III. DISCUSSION

We discuss the following issues in this case:

A. Sexual Harassment

1. Did the superior court properly instruct the jury as to whether VECO could be held liable for hostile environment sexual harassment committed by a supervisor acting outside the scope of his employment?
2. Did the superior court err in denying VECO's motions for JNOV and for a new trial on Rosebrock's hostile environment sexual harassment claim?
 - a. Was the evidence sufficient to support a finding that the harassment was severe or pervasive?
 - b. Was the harassment committed by a supervisor whose actions can be imputed to VECO?
3. Are damages for emotional distress caused by sexual harassment barred by the exclusive remedy provision of the Alaska Workers' Compensation Act?

B. Wrongful Termination

1. Did the superior court err by permitting Rosebrock to amend her complaint after the trial had concluded?
2. Did the superior court properly instruct the jury as to whether VECO [**910] could be held liable for the alleged wrongful termination of Rosebrock?
3. Did the superior court properly instruct the jury on mixed motives?
4. Did the superior [**7] court err in denying VECO's motions for JNOV and for a new trial on Rosebrock's wrongful termination claim?

C. Punitive Damages

1. Are punitive damages authorized under AS 18.80.220 and AS 22.10.020(i)?
2. Did the jury instructions err in permitting the jury to award punitive damages against VECO for acts of a supervisor beyond the scope of the supervisor's employment?

3. Did VECO properly object to the punitive damage instruction?

The parties have also briefed additional issues which do not require discussion for reasons set out in footnote 37, pages 44-45.

A. Sexual Harassment

[HN1] A section of Alaska's anti-discrimination statute makes it unlawful for an employer "to discriminate against a person in compensation or in a term, condition, or privilege of employment because of the person's . . . sex . . . when the reasonable demands of the position do not require distinction on the basis of . . . sex . . ." AS 18.80.220(a) (1). In *French v. Jadon, Inc.*, 911 P.2d 20 (Alaska 1996), we held that this section prohibited sexual harassment. Further, we accepted the customary division of sexual harassment claims into those involving a quid pro quo [**8] and those which merely involve a hostile work environment.

Concerning the former, we noted that "[HN2] quid pro quo gender harassment occurs when an employer conditions employment benefits on sexual favors. It arises when an employer relies upon his or her authority 'to extort sexual consideration from an employee.'" *Id.* at 26 (citation omitted) (quoting *Canada v. Boyd Group, Inc.*, 809 F. Supp. 771, 777 (D. Nev. 1992)). With respect to the latter we noted that [HN3] in

hostile work environment cases, "employees work in offensive or abusive environments. Conduct which unreasonably interferes with work performance can alter a condition of employment and create an abusive working environment." . . .

. . . Discriminatory behavior sufficiently severe or pervasive to alter the conditions of the victim's employment and to create a discriminatory hostile work environment violates AS 18.80.220.

911 P.2d at 28 (citations and footnote omitted) (quoting *Ellison v. Brady*, 924 F.2d 872, 875, 877 (9th Cir. 1991)).

[HN4] Quid pro quo harassment requires proof that "a tangible employment action resulted from a refusal to submit to a supervisor's sexual demand." n5 [HN5] "Unfulfilled threats" or [**9] "offensive conduct in general" may fall within the hostile work environment classification. n6

-----Footnotes-----

n5 *Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742, 118 S. Ct. 2257, 141 L. Ed. 2d 633 (1998).

n6 *Id.*

-----End Footnotes-----

[HN6] Often a hostile work environment is created by co-employees or supervisors acting beyond the scope of their employment. They are acting for personal reasons and not, even in part, to serve their employer. n7 However, in the case of supervisors, harassment, though beyond the scope of their employment, may be facilitated by their position with the employer.

-----Footnotes-----

n7 [HN7] Restatement (Second) of Agency § 228 defines scope of employment as follows:

(1) Conduct of a servant is within the scope of employment if, but only if:

- (a) it is of the kind he is employed to perform;
- (b) it occurs substantially within the authorized time and space limits;
- (c) it is actuated, at least in part, by a purpose to serve the master, and
- (d) if force is intentionally used by the servant against another, the use of force is not unexpected by the master.

(2) Conduct of a servant is not within the scope of employment if it is different in kind from that authorized by the master, or if it is outside the authorized time or space limits, or too little actuated by a purpose to serve the master.

-----End Footnotes----- [**10] [HN8]

[*911] An employer is generally vicariously liable only for acts of employees acting within the scope of employment. However, vicarious liability may also be imposed based on apparent authority or when the employee is aided in accomplishing a tort by the employee's position with the employer. n8 But an employer's vicarious liability for punitive damages is limited by the Restatement (Second) of Agency to acts of (1) managerial employees acting within the scope of their employment. n9 Alaska case law has eliminated the requirement that the acts be managerial, n10 but not the requirement that their acts be within the scope of their employment.

-----Footnotes-----

n8 [HN9] Section 219 of the Restatement (Second) of Agency provides in relevant part:

- (1) A master is subject to liability for the torts of his servants committed while acting in the scope of their employment.
- (2) A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless:

(d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.

[**11]

n9 [HN10] Section 217C of the Restatement (Second) of Agency provides:

Punitive damages can properly be awarded against a master or other principal because of an act by an agent if, but only if:

- (a) the principal authorized the doing and the manner of the act, or
- (b) the agent was unfit and the principal was reckless in employing him, or
- (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or
- (d) the principal or a managerial agent of the principal ratified or approved the act.

n10 See *Alaskan Village, Inc. v. Smalley*, 720 P.2d 945, 948-49 (Alaska 1986).

-----End Footnotes-----

These principles are dispositive of the present case.

1. Did the superior court properly instruct the jury as to whether VECO could be held liable for hostile environment sexual harassment committed by a supervisor acting outside the scope of his employment? n11

-----Footnotes-----

n11 [HN11] Jury instructions involve questions of law, which this court reviews using its independent judgment. See *Aviation Assocs., Ltd. v. Temco Helicopters, Inc.*, 881 P.2d 1127, 1130 n.4 (Alaska 1994). An erroneous statement of law in jury instructions will not be reversed unless prejudice is shown. Id.

-----End Footnotes----- [**12]

VECO claims that the superior court's instructions on liability were erroneous because they allowed the jury to impose "strict liability" on it if a low-level supervisor subjected Rosebrock to hostile environment sexual harassment, or if a low-level supervisor knew about the harassment, but failed to take remedial action. It argues that it should only be



From Restatement DLR