Creditors' Rights in Trusts: Spendthrift, Discretionary Interest and Other Trust Terms Affecting Creditors' Rights Under *Restatement (Third) of Trusts*

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I. Syllabus:

A. Use of trusts in estate planning has expanded exponentially. Revocable trusts are commonly used today as will substitutes. Irrevocable trusts are created frequently for reducing death taxes, making protected gifts and providing supplemental care while preserving entitlement to governmental benefits. It is not surprising that creditors' issues are arising more often in the context of trust administration. What are the rights of a deceased settlor's creditors? When can creditors attach beneficial interests? What rights do creditors have after they have attached beneficial interests? Can creditors compel exercise of trustee discretion? Colorado has few laws governing creditors' rights in these contexts. What are the Colorado rules? What are the *Restatement* rules and why should Colorado lawyers be familiar with them? How do the *Uniform Trust Code* rules compare? This program will examine creditors' rights in trusts through common fact patterns and endeavor to identify the rules applicable in Colorado.

II. Fundamental Principles:

A. Beneficial Interests Are Property:

A beneficial interest in a trust may be a present or future interest; it may be subject to conditions with respect to the recipients or the extent of the interest. A beneficial interest may be subject to the discretionary decisions of a trustee or of another, or it may be subject to a power of appointment or a power of revocation or amendment. There is practically no limit to the variety of interests a settlor may create. *Restatement (Third) of Trusts,* section 49 cmt. b.

Is a beneficial trust interest a property interest of the beneficiary or is it merely a chose in action against the trustee? This question is important in the context of creditor claims. If a beneficial interest is property it will be exposed to the claims of the beneficiary's creditors.

The prevailing view in the United States and England is that a beneficiary of a trust has a property interest in the subject matter of the trust and not a mere chose in action. II William F. Fratcher, *Scott on Trusts*, section 130 (14th ed. 1987). In discussing whether a beneficiary has a property interest, the *Scott* treatise notes "....It must be remembered, however, that the chancellors at the beginning gave him [the beneficiary] no more than a claim against the trustee, and only gradually gave him proprietary rights. The growth of the trust has been a process of evolution. ....The principle that a beneficiary of a trust has a proprietary interest in the subject matter of the trust has been accepted by the Supreme Court of the United States." See *Senior v. Brader*, 295 U.S. 422, 55 S.Ct 800, 79 L. Ed. 1520 (1935) and *Blair v. Comm'r of Internal Revenue*, 300 U.S. 5, 57 S.Ct. 330, 81 L.Ed. 465 (1937). *Restatement (Third) of Trusts,* section 49 and Rptr's Notes of section 49.

This fundamental principle has been recognized by the Colorado Supreme Court in *In re Marriage of Jones,* 812 P.2d 1152 (Colo. 1991) ("a beneficiary has an equitable interest in the subject matter of the trust").

B. Attachment By Creditors:

Except as limited by spendthrift and other restrictions imposed by the terms of the trust or resulting from the nature of the beneficial interest itself, creditors can attach a beneficiary's trust interest in satisfaction of the creditor's claim. *Restatement (Second) of Trusts,* sections 147-149 and 162; II William F. Fratcher, *Scott on Trusts,* sections 147-147.3, 148, 149, and 162 (4th ed. 1987); *Restatement (Third) of Trusts*, section 56.

III. Scope of Discussion:

The property interest of a trust beneficiary is subject to "attack" in many contexts.

A. Creditor Claims:

When can a beneficiary's general creditors attach his or her beneficial interest? After a beneficial interest has been attached, what rights do creditors have to satisfy their claims out of the beneficiary interest?

B. Divorce:

When is a beneficial trust interest sufficiently unlimited so that it can be treated as "property" for purposes of division of "marital property" in a divorce proceeding?

C. Disqualification for Government Benefits:

When is a beneficial trust interest sufficiently "available" to the beneficiary to be treated as a "countable resource" in disqualifying the beneficiary for Medicaid and other government welfare benefits?

All of these questions are important. However, this discussion will be limited to creditors' rights.

IV. Trusts and Asset Protection:

Moreover, this discussion will focus on traditional trust law principles having a direct bearing on creditor rights. Issues involving domestic asset protection trusts under the laws of Alaska, Delaware, Rhode Island, Nevada, Utah and South Dakota and involving "off-shore" asset protection trusts are beyond the scope of this discussion. The asset protection attributes of other techniques and devices (e.g. IRA accounts, life insurance policies, section 529 plans, business entities, etc.) are also beyond the scope of this discussion. The law of fraudulent transfer, while always having bearing on self-settled asset protection planning, will not be considered either.

What are the traditional common law principles that protect beneficial interests from creditor claims?

A. Spendthrift:

A provision that prohibits both voluntary (i.e. assignment) and involuntary (i.e. attachment) alienation of a beneficial interest generally provides direct protection against the claims of the beneficiary's creditors.

B. Discretion:

Whether or not a trust contains a valid spendthrift provision, creditors who are able to attach the beneficial interest generally are not able to force exercise of discretion.

C. Forfeiture:

A trust may provide for termination of a beneficial interest or for a protective transformation of a beneficial interest if there is an attempt to attach it by the beneficiary's creditors.

D. There are important common law exceptions to these rules.

V. Colorado Law:

As suggested in the syllabus, this discussion will focus on applicable Colorado law with respect to creditors' rights. Unfortunately, Colorado law in this area is quite thin. The few notable Colorado decisions concerning creditors' rights in beneficial interests are included in your materials.

This discussion will also consider the *Restatement (Third) of Trusts*. What is a *Restatement*? Why should Colorado lawyers be concerned about *Restatements* generally and *Restatement (Third) of Trusts* specifically when considering rights of creditors?

A. *Restatements*:

Restatements are written by the American Law Institute (ALI). Generally, a *Restatement* is a document that collects and summarizes in one place the common law on a particular subject. Where court decisions are in conflict, a *Restatement* strives to delineate the better rule. *Restatements* also fill in gaps in the law and thus promote the rule that a court should apply when encountering an issue for the first time. The hope is that state courts, by relying on *Restatements* as a primary guide for decisions, will over time adopt uniform rules of decision.

By comparison, uniform laws are written by the National Conference of Commissioners on Uniform State Laws (NCCUSL). Uniform laws are written for enactment by the states with the goal of creating uniform statutory rules on a particular subject.

While *Restatements* attempt to summarize the common law on a particular subject and point out the better rule when the common law is in conflict, courts are free to ignore the *Restatement* position. On the other hand, once a state enacts a uniform law, courts must follow the statutory rules.

B. *Restatements* and Colorado Court Decisions:

Because of the gaps in Colorado trust law, when an issue arises for the first time in Colorado, our courts have had little to guide them in making decisions. Colorado appellate courts have routinely resorted to and relied upon the *Restatement* position in such circumstances. In fact, as of November 2004, the Supreme Court and Colorado Court of Appeals had cited and followed the *Restatement* position in 59 cases where there had been no Colorado trust law on the issue before the court. See Kevin Millard, *The Uniform Trust Code, Appendix C,* November 2004, summarizing these 59 decisions. It is reasonable to infer from Mr. Millard's analysis that Colorado

courts will continue to follow the *Restatement* position where there is no Colorado statute or decision on point. This is especially true with respect to the rights of a trust beneficiary's creditors. We must therefore be very familiar with the *Restatement* rules.

VI. Policies Underpinning the *Restatement* Rules:

A. Self-Settled Spendthrift Trusts:

Common law has traditionally disfavored self-settled spendthrift trusts. Irwin N. Griswold, *Spendthrift Trusts*, sections 474 and 475 (2nd ed. 1947); *Restatement (Second) of Trusts*, section 156(1); *Restatement (Third) of Trusts*, section 58(2); and *Uniform Trust Code*, section 505(a)(2).

Accordingly, under the *Restatement* a restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor is invalid. *Restatement (Third) of Trusts*, section 58(2).

B. Functional Equivalents:

The *Restatement* emphasizes substance over form and treats functional equivalents the same.

1. Revocable Trusts and Wills:

Under the *Restatement*, revocable trusts are recognized as valid will substitutes. Accordingly, such trusts and their settlors and beneficiaries are treated in like manner as wills and their testators and beneficiaries both during the life and after the death of the settlor and testator. Wills and revocable trusts are functional equivalents. This is especially relevant in the context of creditor claims. Property of a revocable trust is treated as if it were owned by the settlor. *Restatement (Third) of Trusts*, section 25 cmt. a.

2. Power of Revocation and of Withdrawal:

A power of revocation and a reserved power of withdrawal are treated the same with respect to the power holder's creditors. *Restatement (Third) of Trusts*, section 56 cmt. b.

C. Ownership Equivalence:

1. Powers of Appointment:

a. General Powers of Appointment: Property subject to a general power of appointment, including one in the form of a power of withdrawal, is treated as the property of the power holder because the power holder can appoint the property subject to the power to himself or herself or can apply the property in discharge of his or her legal obligations. *Restatement (Third) of Trusts,* section 56 cmt. b.

b. Special Power of Appointment: Since property subject to a special power of appointment cannot be appointed to the power holder or applied in discharge of his or her legal obligations, such property is not subject to the power holder's creditors. *Restatement (Third) of Trusts*, section 56 cmt. b.

c. Other Beneficiaries: Conversely, the interests of beneficiaries (other than power holders) in trust property subject to a power of revocation, a power of withdrawal, or a general power of appointment, are not treated as their property and cannot be reached by the creditors of such other beneficiaries. They have mere expectancies. *Restatement (Third) of Trusts*, section 56 cmt. b and *Restatement (Third) of Trusts*, section 25(2) cmt. a.

D. Restrictions on Disposition of Property:

The *Restatement* recognizes the evolved rule of common law holding that owners of property may not dispose of it in any way that they desire. There are restrictions on the right of disposition. Such restrictions are founded on public policy considerations. Some of the more familiar restrictions on freedom of disposition are: (i) forced heirship; (ii) elective rights of surviving spouses; (iii) rule relating to perpetuities; (iv) prohibitions against trusts with indefinite beneficiaries; (v) illegal purposes or unreasonable restraints on marriage or that encourage divorce or neglect of duties; (vi) rules prohibiting restraints on alienation of legal interests. *Restatement (Third) of Trusts*, section 29; *Restatement (Third) of Trusts*, section 58 Rptr's Notes on cmt. a.

In the context of trust creation for our clients, we as practitioners must disabuse ourselves and our clients of the notion that they can create discretionary beneficial interests that are absolutely protected from court review. For policy reasons, it not

possible to create terms of trust that prohibit court review of trustee discretion no matter how broad or expanded the grant of discretion. Such a provision, if engrafted into the terms of a "trust", would not create a trust at all but would create a gift to the "trustee". Thus, a beneficiary of a discretionary trust always has an enforceable right, exercisable in court, to prevent abuse of discretion. *Restatement (Second) of Trusts*, section 187 cmt. k; *Restatement (Third) of Trusts*, section 50 cmt c.

See also policy restrictions on the spendthrift rule. *Restatement (Third) of Trusts*, sections 58, Rptr's Notes on cmt. a and 59 cmt. a.

VII. Resources:

A. Research Summary, Stanley C. Kent, *Spendthrift, Discretionary Interests and Other Trust Terms Affecting Creditors' Rights Under Restatement (Third) of Trusts*, presented at The 2005 Fall Estate Planning Update, Denver, Colorado, November 11, 2005 (revised and updated for this program).

B. Statutes:

i. 38-10-111 *Colorado Revised Statutes*; and
ii. 15-15-103 *Colorado Revised Statutes* (effective July 1, 2006).

C. Cases:

i. *In re Baum*, 22 F.3d 1014 (10th Cir. 1994);
ii. *Brasser v. Hutchison*, 549 P.2d 801 (Colo. App. 1976);
iii. *In re Cohen*, 8 P.3d 429 (Colo. 1999);
iv. *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991);
v. *Kaladic v. Kaladic*, 589 P.2d 502 (Colo. App. 1978);
vi. *Lagae v. Lackner*, 996 P.2d 1281 (Colo. 2000);
vii. *In re McCart*, 847 P.2d 184 (Colo. App. 1992);
viii. *Newell v. Tubbs*, 84 P.2d 820 (1938);
ix. *Snyder v. O'Conner*, 81 P.2d 773 (1938); and
x. *University National Bank v. Rhoadarmer*, 827 P.2d 561 (Colo. App. 1991).

D. Articles:

i. Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J. 567, Fall 2005; and
ii. Richard E. Davis and Stanley C. Kent, *The Impact of the Uniform Trust Code on Special Needs Trusts*, 1 NAELA J. 235 (2005).

Scenario I
Revocable Trust

Mother creates and funds a revocable trust for her benefit with remainder at her death to her son. At the time the trust is created, mother has no creditors. She serves as trustee of this trust.

A. Some years later mother has creditors. What rights do these creditors have in her revocable trust property while she is living?

1. Colorado rule: See discussion of section 38-10-111 *C.R.S.* infra.

2. *Restatement* rule: *Restatement (Third) of Trusts*, section 25 cmt. e and section 56 cmt. b.

3. *Uniform Trust Code* rule: *UTC*, section 505(a)(1).

B. Mother dies without having paid her creditors. What rights do her creditors have with respect to the property of her revocable trust post mortem?

1. Colorado rule: Section 15-15-103 *C.R.S.*, effective July 1, 2006.

2. *Restatement* rule: *Restatement (Third) of Trusts*, section 25, cmt. e.

3. *Uniform Trust Code* rule: *UTC*, section 505(a)(3).

C. Suppose the beneficiary's son has creditors too. What rights do his creditors have with respect to his interest in his mother's revocable trust while she is living?

1. Colorado rule: None.

2. *Restatement* rule: See *Restatement (Third) of Trusts*, section 25 cmts. a and e and section 56 cmt. b.

Restatement policy: The property of the mother's revocable trust is treated as her property while she is living. Accordingly, the son is treated as having a mere expectancy which cannot be reached by his creditors.

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Scenario II
Self-Settled Irrevocable Trust

Father creates and funds an irrevocable trust. A bank is designated as trustee. The trustee's discretionary distribution power is described as follows:

> ***
>
> "Trustee may distribute such amounts of income and principle as trustee deems necessary to daughter for life with remainder to daughter's issue; provided, however, that at any time, in its absolute discretion, trustee may distribute to or apply for benefit of father any amounts of income or principle as trustee deems appropriate for father's comfortable support."
>
> ***

Although father has no creditors when the trust is created and funded, creditors to arise thereafter.

A. Would a spendthrift provision make any difference in this case? No

- c/o Spendthrift – Creditors can attach
- w/ Spendthrift – same result
- 38-10-111 does not apply

1. *Restatement (Third) of Trusts*, section 58(2).

All of trust not necessarily available

B. Can father's creditors attach his discretionary interest?

1. Colorado rule: ?

2. *Restatement* rule: Generally, absent a valid spendthrift provision, creditors can attach the beneficial interest. *Restatement (Third) of Trusts*, section 60 cmts. c and f.

3. *UTC* rule: *UTC*, section 505(a).

C. If creditors are able to attach the father's beneficial interest. What can these creditors do then? What is the effect of trustee discretion on their rights?

1. Colorado rule: None.

2. *Restatement* rule: *Restatement (Third) of Trusts*, section 60 and cmt. f. Where the trustee of an irrevocable trust has discretionary authority to pay to the settlor or apply for the settlor's benefit so much of the income or principal

as the trustee may determine appropriate, creditors of the settlor can reach the maximum amount the trustee, in the proper exercise of fiduciary discretion, could pay to or apply for the benefit of the settlor.

D. Are there any Colorado legal principles that might have bearing on creditors' rights? Remember, when father created this trust, he had no present or potential subsequent creditors.

1. What is the effect of section 38-10-111 *C.R.S.*? This particular Colorado statute says that "...all transfers ... made in trust for the use of the person making same shall be void against the creditors existing of such person." Assuming that a settlor has no creditors when an irrevocable trust is created for his benefit, can his subsequent creditors reach the trust property? Is Colorado an asset protection jurisdiction?

2. See *In re Baum*, 22 F. 3d 1014 (10th Cert. 1994) and *In re Cohen*, 8 P.3d 429 (Colo. 1999). See, too, *Kaladic v. Kaladic*, 589 P.2d 502 (Colo. App. 1978).

Scenario III
Third-Party Settled Irrevocable Trust - Spendthrift

Grandmother creates an irrevocable trust for her grandson. Relevant terms of trust are these:

> ***
>
> "Trustee shall distribute to settlor's grandson as much of the net income and principal of the trust as is necessary or advisable for his health, education, support or maintenance."
>
> ***
>
> "This is a spendthrift trust."
>
> ***

The grandson's beneficial interest is to last for life with remainder to her other grandchildren or their descendants, *per stirpes*.

The grandson is a good kid but he falls on hard times financially after he negligently causes an automobile accident. His creditors consist of: (i) a judgment creditor for uninsured personal injuries; (ii) unpaid hospital bills for treatment of the grandson's life threatening injuries; (iii) credit card debt to finance an extravagant life style; and (iv) unpaid child support obligations.

A. Is this spendthrift trust protective?

1. Colorado rule: Colorado recognizes the validity of spendthrift trusts. *Newell v. Tubbs,* 84 P.2d 820 (1938) and *Snyder v. O'Conner,* 81 P.2d 773 (1938). But, are these terms sufficient to create a valid spendthrift trust in Colorado?

2. *Restatement* rule: *Restatement (Third) of Trusts*, section 58.

3. *Uniform Trust Code* rule: *UTC,* section 502.

B. Assume the spendthrift provision is valid. Can any of grandson's creditors avoid the spendthrift rule?

1. Colorado rule: There is no Colorado case or statute recognizing spendthrift exception creditor classes.

2. *Restatement* rule: The *Restatement* recognizes certain public policy exceptions to spendthrift. *Restatement (Third) of Trusts*, section 59.

a. General Creditors?: *Restatement (Third) of Trusts,* sections 58 and 59.

b. Necessities Providers?: *Restatement (Third) of Trusts*, section 59(b).

c. Child Support Claimants?: *Restatement (Third) of Trusts*, section 59(a).

d. Tort Creditor?: *Restatement (Third) of Trusts*, section 59, cmt. a (2).

3. *Uniform Trust Code rule*: *UTC*, section 503.

C. What can attaching, spendthrift - avoiding creditors do to satisfy their claims?

1. Colorado rule: None.

2. *Restatement* rule: See *Restatement (Third) of Trusts*, section 56, cmt. e.

3. *Uniform Trust Code* rule: *UTC*, section 503 (c).

D. Suppose this settlor had incorporated the following provision into her trust:

"If settlor's grandson attempts to assign his beneficial interest or if a creditor attempts to attach his interest, his interest shall immediately terminate and the trust property shall be distributed to his descendants, *per stirpes*.

Is such a forfeiture provision valid ?

1. Colorado rule: None.

2. *Restatement* rule: See *Restatement (Third) of Trusts*, section 57.

3. *Uniform Trust Code* rule: None.

E. Suppose this settlor had reserved an *inter vivos* general power of appointment over the entire trust property. Or, suppose settlor had granted a general power of appointment to her granddaughter. Would such a provision have been protective against the grandson's creditors?

1. Colorado rule: None.

2. *Restatement* rule: *Restatement (Third) of Trusts,* section 56, cmt. b.

3. *Uniform Trust Code* rule: None.

F. Suppose this trust included a provision authorizing trustee to make discretionary distributions to or for benefit of the grandson. Are these discretionary/spendthrift trust terms more protective?

1. Spendthrift prevents attachment by creditors until distribution to the beneficiary. Once trust property is in the beneficiary's hands, his creditors can attach it. *Restatement (Third) of Trusts*, section 58 cmt. d(2). Accord, *UTC*, section 502(c). See also *Snyder v. O'Conner*, 81 P.2d 773 (Colo. 1938).

2. Distributions for benefit of a beneficiary (e.g. direct payment of beneficiary's rent, insurance premiums, necessities, etc.) are presumably beyond the reach of the beneficiary's creditors. *Restatement (Third) of Trusts*, section 58 cmt. d(2).

3. But what if the terms do not expressly authorize distributions for benefit of the beneficiary? Is it a breach of duty for trustee to make distributions to someone other than the beneficiary? Perhaps not. *Restatement (Third) of Trusts*, section 49 cmt. c(2), providing: "A trustee who improperly applies or distributes income in good faith for the support, care, or other needs of the beneficiary (whether or not under a legal disability) is entitled to credit in the trust accounts to the extent the beneficiary would otherwise be unjustly enriched."

Scenario IV
Third Party Irrevocable Trust - Discretion

Assume the same facts in Scenario III.

However, there is no spendthrift provision in the terms of the trust.

A. Because there is no spendthrift provision, all of the grandson's creditors have attached his beneficial interest. The trustee, realizing this, has decided to make no discretionary distributions at all until the creditor issues go away. What rights do the creditors have to satisfy their claims out of the discretionary interest?

B. *Restatement* rule:

1. The general rule is in *Restatement,* section 56, cmt. e.

   a. Creditors must first attempt to satisfy claims out of the beneficiary's legal interests.

   b. Court may grant creditors appropriate relief out of the beneficial interest. E.g. direct trustee to make distributions that are mandatory (not discretionary) to creditors first.

   c. Court must take into account the needs of the beneficiary. Consider the beneficiary's other resources.

   d. But what can a court do if the beneficial interest is discretionary? The rule is in *Restatement (Third) of Trusts*, sections 60 and 56 cmt. e.

   e. Can a court order judicial sale of the beneficial interest? See *Restatement (Third) of Trusts*, sections 60 cmt. c and 56 cmt. e.

2. Can creditors who have attached (no spendthrift restraint) force exercise of discretion?

   a. The rule is in *Restatement (Third) of Trusts*, section 60. But see cmt. e.

   b. How does the beneficiary's interest weigh in? *Restatement (Third) of Trusts,* section 60 cmt. e.

3. The terms of this trust contain a support standard. What if the attaching creditor is a child with a judgment for support? Or a creditor who has provided necessary support to the beneficiary?

   a. *Restatement (Third) of Trusts*, section 60 cmt. e(1) and Rptr's notes to cmt. e and e(1).

4. Suppose grandmother had reserved a general power of appointment over this trust principle? Would this have an effect upon creditor rights where the debtor's interest is not protected by spendthrift? What if grandmother had added a forfeiture provision to the trust? Protective?

   a. *Restatement (Third) of Trusts*, section 56 cmt. b.

5. Suppose the terms of grandmother's trust allow the trustee to make distributions to or for benefit of the beneficiary? In this context (no spendthrift provision) would the trustee be able to make distributions for benefit of the beneficiary thereby getting around the attaching creditor problem?

   a. *Restatement (Third) of Trusts*, section 60 cmt. c.

C. Colorado rule:

1. In the case of *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991) the Supreme Court held that a beneficiary's interest in a discretionary trust was not "property" for purposes of division of property in a divorce case. In reaching this conclusion, the Court relied on a common law attribute of discretionary interest, to wit: absent an abuse of discretion, a beneficiary may not obtain a court order compelling the trustee to make distributions from the trust.

   The Supreme Court also mentioned, in passing, that "the interest of the beneficiary in a discretionary trust is not assignable and cannot be reached by his or her creditors." Whether or not a beneficiary can assign, or a creditor can attach, the beneficiary's interest in trust depends on whether the interest is subject to a valid spendthrift provision. The facts reported in *Jones* do not indicate whether or not the discretionary interest was subject to spendthrift protection.

What is clear, however, is that *Jones* is not a creditor rights case. The Supreme Court did not address whether and under what circumstances an attaching creditor might be able to obtain court review of a trustee's exercise of discretion.

D. *Uniform Trust Code* rule:

1. See *UTC*, section 504(b).

Scenario V
Irrevocable By-Pass Trust

A deceased wife's will contains a rather routine marital deduction/exemption equivalent tax plan. Pursuant to formula, her "family trust" is funded with $2,000,000.00. She has designated her husband as a beneficiary and as the trustee of this trust. The relevant trust terms provide:

> ***
>
> "Trustee shall distribute to or apply for the benefit of settlor's spouse and settlor's descendants as much of the net income and principle of the family trust as trustee deems necessary or advisable for their health, education, support, or maintenance; provided, however, that no distribution of income or principle shall be made to settlor's children which would operate to discharge or relieve settlor's spouse of any legal obligation the spouse may have to support settlor's children."
>
> ***.

Husband's interest is subject to a spendthrift provision.

A. Husband has substantial debt. What rights do his creditors have as against the property of the exemption trust?

B. See *Restatement* (Third) of Trusts, section 60 cmt. g.

Under the *Restatement* rule, the husband's creditors are able to reach the maximum amount that the husband, as trustee, can properly take in the exercise of discretion. In other words, pursuant to the *Restatement* position, the husband, as trustee with authority to distribute to himself, has an ownership equivalence reachable by his creditors. *Restatement (Third) of Trusts*, section 60, cmt. g and section 56, cmt. b.

Compare this property rule with the familiar tax rules in IRC, section 3041 and 2514. See also *Restatement (Third) of Trusts,* section 60 Rptrs. notes on cmt. g.

Does the spendthrift provision protect nonetheless? See *Restatement (Third) of Trusts,* section 58 cmt. b(1). Notwithstanding the rule of section 60 cmt. g, if the interest is subject to a spendthrift provision is the "ownership equivalence" problem eliminated? Spendthrift may nevertheless be valid

C. Compare the *Uniform Trust Code* rule under section 504 (e).

D. Suppose wife had instead designated a bank as trustee of this by-pass trust. To soften the perceived negative impact on her husband, she granted to him a traditional tax rule "5 x 5 withdrawal power." What rights do his creditors have with respect to property subject to the power?

1. Colorado rule: See *University National Bank v. Rhoadarmer*, 827 P.2d 561 (Colo. App. 1991).

   a. *Restatement* rule: See *Restatement (Third) of Trusts*, section 56 cmt. b. Does husband have an ownership equivalence over property subject to the 5 x 5 withdrawal power?

   b. *Uniform Trust Code* rule: See *UTC*, section 505 (b)(1).

2. What about the husband's discretionary beneficial interest? Would the Colorado rule in *Rhoadarmer* protect the husband as trustee/beneficiary? Is a discretionary power of self distribution akin to a withdraw power in this context notwithstanding that the former power is held in a fiduciary capacity while the later is not held in a fiduciary capacity?

Scenario VI
Drafting a Protective Trust

Clients want to draft a trust to protect against claims of their spendthrift child's creditors. Drawing on the *Restatement* and Colorado rules, how would we write such a trust?

A. Spendthrift. *Restatement (Third) of Trusts*, section 58; *Snyder* and *Newell* cases.

B. Discretionary Trust. *Restatement (Third) of Trusts*, section 50.

1. Support standards or not? *Restatement (Third) of Trusts*, section 50 cmt. d. Not

2. Extended discretion? E.g. the terms such as "absolute", "unlimited", or "sole and uncontrolled". Eliminate reasonableness in exercise of discretion. *Restatement (Third) of Trusts*, section 50 cmt. c.

3. Allow distributions for "benefit of". *Restatement (Third) of Trusts*, section 58.

4. Other terms:

   a. "Shall" versus "may". *Restatement (Third) of Trusts*, section 50 cmt. g.

   b. "Benefit". *Restatement (Third) of Trusts*, section 50 cmt. d(3).
   ↳ Rather, "As Te deems best"

   c. "Restrictive standards": "emergency", "severe hardship", "disability". *Restatement (Third) of Trusts*, section 50 cmt. d(4).

5. Allow for accumulation of income and adding to principle.

Remove words "reasonable"

C. Trust terms should be for life of the "problem" beneficiary. Remainder over to others.

1. Consider the nuances in these terms: "the remainder" versus "whatever remains". *Restatement (Third) of Trusts*, section 50 cmt. g.

D. Multiple Beneficiaries. I.e. a sprinkle trust. *Restatement (Third) of Trusts*, section 50 cmt. f.

E. Independent trustee. *Restatement (Third) of Trusts*, section 60 cmt. f.

F. Consider use of a general power of appointment. A reserved power or a power granted to another, perhaps another child. *Restatement (Third) of Trusts*, section 56 cmt. b.

G. Consider including a forfeiture provision. *Restatement (Third) of Trusts*, section 57.

Research Summary

Stanley C. Kent

Spendthrift, Discretionary Interests and Other Trust Terms
Affecting Creditors' Rights
Under
Restatement (Third) of Trusts

(Revised for 2006 Estate Planning Retreat)

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Spendthrift, Discretionary Interests and Other Trust Terms Affecting Creditors' Rights Under *Restatement (Third) of Trusts*

By:
Stanley C. Kent

This paper discusses creditor's rights under the *Restatement (Third) of Trusts*. Secondary goals are to demonstrate why Colorado lawyers must be familiar with *Restatement* rules in the context of creditor's rights, and to compare such *Restatement* rules to existing Colorado law and to the *Uniform Trust Code* which has been proposed for enactment in Colorado.

I. *Restatements* and Uniform Law:

A. *Restatements*:

Restatements are written and approved by of the American Law Institute. Generally, a *Restatement* is a document that collects and summarizes in one place the common law on a particular subject. However, there is more to a *Restatement* than this. Where court decisions are in conflict, a *Restatement* strives to delineate the better rule. A *Restatement* also tries to fill in gaps in the law and thus to promote the rule that a court should apply when encountering an issue for the first time. The hope is that state courts, by relying on the *Restatement* as a primary guide for decisions, will over time adopt uniform rules of decision. David M. English, *The Uniform Trust Code 2000*, Annual Uniform Trust Code National Conference, Chicago, Illinois, June 26, 2005.

Work on the *Restatement (Third) of Trusts* began in the late 1980s. The portion of this *Restatement* relating to the prudent investor rule and other investment topics was completed and approved in 1990. The portion dealing with rules of creation and validity of trusts was approved in 1996; the portion covering the office of trustee, trust purposes, spendthrift provisions and rights of creditors was approved in 1999. The portion relating to trust modification and termination was approved in 2001. David M. English, *The Uniform Trust Code 2000*, supra.

The *Restatement (Third) of Trusts* is not completed and work continues.

B. Uniform Laws:

Uniform laws are written by the National Conference of Commissioners on Uniform State Laws (NCCUSL). NCCUSL not only drafts and promulgates uniform laws, it also urges their enactment.

NCCUSL commissioners are lawyers appointed by all of the states to provide non-partisan, balanced legislation with the goal of increasing harmony of law across state lines.

The *Uniform Trust Code* (*UTC*) is a NCCUSL product.

The *UTC* drafting process began in 1994 and was completed in 2000. Portions of the *UTC* were amended in 2001, 2003, 2004 and 2005.

The *UTC* drafting committee was made up of representatives from The American Bar Association and its Section on Real Property, Probate and Trust Law, the American College of Trust and Estate Council (ACTEC), the American Bankers Association, and the California and Colorado State Bars. The Joint Editorial Board for Uniform Trust and Estates Acts and the ACTEC Committee on State Laws provided advise to the drafting committee.

C. Relationship Between the *Restatements* and Uniform Laws:

While *Restatements* attempt to summarize the common law on a particular subject and point out the better rule when common law is in conflict, courts are free to ignore *Restatement* position and create their own rules. On the other hand, once a state enacts a uniform law, courts must follow the statutory rules.

D. Impact of the *Restatement (Third) of Trusts* on Colorado:

Colorado statute and case law on trusts is sparse. When an issue of trust law arises for the first time in Colorado, our courts have little guide them in making decisions. Colorado appellate courts have routinely resorted to and relied upon the *Restatement* position in such circumstances. In fact, the Colorado Court of Appeals and Supreme Court have cited and followed the *Restatement* position in 59 cases where there has been no Colorado trust law on the issue before the court. See Kevin D. Millard, *The Uniform Trust Code*, Appendix C, November 2004, summarizing these 59 decisions. Of these 59 decisions, three have cited and followed *Restatement (Third) of Trusts*. See *Buder v. Sartore*, 774 P.2d 1383 (Colo. 1989) citing *Restatement (Third) of Trusts* (prudent investor rule), section 277 (tent. draft no. 1 1988); *In re Estate of Heyn*, 47 P.3d 724 (Colo. App. 2002) citing *Restatement (Third) of Trusts*, section 170 (1990); and *In re Estate of Klarner*, 98 P3d. 892 (Colo. App. 2003) citing *Restatement (Third) of Trusts*, section 37 cmt. f(1).

It is reasonable to infer from Mr. Millard's analysis that Colorado courts will continue to follow the *Restatement (Third) of Trusts* when there is no Colorado statute or decision on point. This is especially true with respect to the rights of a trust

beneficiary's creditors. It therefore behooves Colorado practitioners to be very familiar with these *Restatement* rules.

II. Extent of Beneficial Interests:

A. ***Rule of Restatement (Third) of Trusts, section 49:***

Extent of Beneficiaries' Interests

Except as limited by law or public policy (see section 29), the extent of the interest of a trust beneficiary depends upon the intention manifested by the settlor.

B. Discussion:

The interests of beneficiaries are usually prescribed with reasonable clarity by the expressed provisions of a trust. When this is not the case, uncertainties may be resolved through the process of interpretation or by application of rules of construction. The terms of the trust describing interests of beneficiaries will be respected and given effect unless contrary to public policy. *Restatement (Third) of Trusts,* section 49 cmt. a.

The interest of a beneficiary may be a present or a future interest; and a beneficial interest may or may not be subject to conditions with respect to recipients or the extent of the interest. A beneficial interest may be subject to the discretionary decisions of a trustee or of another, or may be subject to a power of appointment or a power of revocation or amendment. There is practically no limit to the variety of interests a settlor may correct provided there is no violation of public policy limitations. *Restatement (Third) of Trusts*, section 49 cmt. b.

C. Beneficiaries' Have Property Interests:

Originally, the chancellors gave the beneficiary of a trust nothing more than a *chose in action* or a claim against the trustee. However, the trust has gone through a process of evolution and today it is broadly recognized that the beneficiary of a trust has a property interest in the subject matter of the trust. *Restatement (Third) of Trusts*, section 49, Rptr's Notes on section 49; *Restatement (Third) of Trusts*, section 2, Rptr's Notes on section 2; II William F. Fratcher, *Scott on Trusts*, section 130 (14th ed. 1987); *Senior v. Brader*, 295 U.S. 422, 55 S.Ct 800, 79 L. Ed. 1520 (1935) and *Blair v. Comm'r of Internal Revenue*, 300 U.S. 5, 57 S.Ct. 330, 81 L.Ed. 465 (1937).

D. Freedom of Disposition Versus Public Policy Restraints:

1. **The rule of *Restatement (Third) of Trusts*, section 29:**

Purposes and Provisions That Are Unlawful or Against Public Policy

An intended trust or trust provision is invalid if:

(a) its purpose is unlawful or its performance calls for the commission of a criminal or tortious act;

(b) it violates rules relating to perpetuities; or

(c) it is contrary to public policy.

2. Discussion:

"The rules allowing and limiting the use of trusts, and the time-divided property ownership usually associated with deadhand control, reflect a compromise between free disposition of private property and other values...." The private trust is tolerated, even treasured, in the common-law world for the flexibility it offers to property owners in planning and designing diverse beneficial interests and financial protections over time, individually tailored as the particular property owner deems best to the varied needs, abilities, and circumstances of particular family members and others whom the owner chooses to benefit. Yet these societal and individual advantages are properly to be balanced against other social values and the effects of deadhand control on the subsequent conduct or personal freedoms of others, and also against the burdens a former owner's unrestrained dispositions might place on courts to interpret and enforce individualized interests and conditions....Policies concerned with deadhand control limit the use of trusts in ways that do not apply to living individuals in the direct disposition of their property....Thus, although one is free to give property to another or to withhold it, it does not follow that one may give it in trust with whatever terms or conditions one may wish to attach...(P)recise rules of validity or invalidity frequently cannot be stated. This is particularly so because of the need to weigh the often worthy concerns and objectives of settlors against the objectionable effects or tendencies of conditions attached to beneficial interests,....in these various situations, remedial flexibility is required to reconcile (i) the policy objection to a provision with (ii) a motive or goal of the settlor that is legally acceptable in whole or in part as an effort to protect the beneficiary's interest or the trust property." *Restatement (Third) of Trusts*, section 29 cmt. i. See also the

discussion of public policy considerations underpinning exceptions to the spendthrift rule and discussion of *Restatement (Third) of Trusts*, sections 58 and 59, infra. See also legal and public policy considerations underpinning the necessity of review of trustee discretionary power and discussion of *Restatement (Third) of Trusts*, sections 60 and 50, infra.

III. Revocable Trusts:

B. **Rule of *Restatement (Third) of Trusts*, section 25:**

Validity and Effect of Revocable Inter Vivos Trust

(1) A trust that is created by the settlor's declaration of trust, or by inter vivos transfer to another, or by beneficiary designation or other payment under a life-insurance policy, employee-benefit or retirement arrangement, or other contract is not rendered testamentary merely because the settlor retains extensive rights such as a beneficial interest for life, powers to revoke and modify the trust, and the right to serve as or control the trustee, or because the trust is funded in whole or in part or comes into existence at or after the death of the settlor, or because the trust is intended to serve as a substitute for a will.

(2) A trust that is not testamentary is not subject to the formal requirements of section 17 [creation of testamentary trusts] **or to procedures for the administration of a decedent's estate; nevertheless, a trust is ordinarily subject to substantive restrictions on testation and to rules of construction and other rules applicable to testamentary dispositions, and in other respects the property of such a trust is treated as though it were owned by the settlor.** [cross reference added]

B. Discussion:

The *Restatement* recognizes the validity of revocable trusts and the reality that property owners often prefer such trusts as a means of holding and disposing of their property at death. Accordingly, the revocable trust is a legally accepted will substitute.

The comment to section 25 observes that the "fundamental and persuasive policy underlying this section and related rules of this *Restatement* is that diverse forms of revocable trusts (i) are valid without compliance with Wills Act but (ii) absent persuasive reasons for departure, are subject to the same restrictions (such as spousal

rights) and other rules and constructual aids that are applicable to wills. In other substantive respects (such as creditor's rights), the property held in a revocable trust is ordinarily to be treated as if it were property of the settlor and not of the beneficiaries." *Restatement (Third) of Trusts*, section 25 cmt. a.

The *Restatement* seeks to treat functional equivalents similarly.

Therefore, the rule of this section extends to creditor's rights during the settlor's life and after the settlor's death. *Restatement (Third) of Trusts,* section 25 cmts. a and e.

C. Effect:

Under this *Restatement* rule, property held in a revocable trust is subject to the claims of the creditors of the settlor and of the deceased settlor's estate. Statutory exemptions apply whether the property is titled in the name of the settlor or in the settlor's revocable trust.

1. Policy:

The *Restatement (Third)* position is founded on the policy of basing the rights of creditors on the substance rather than the form of the debtor's property rights. *Restatement (Third) of Trusts* , section 25 cmt. e.

2. Spendthrift:

Rights of a settlor's creditors with respect to the property of a revocable trust are not affected by a spendthrift provision. *Restatement (Third) of Trusts,* section 25 cmt. e. Later in the *Restatement* it is held that a spendthrift interest retained by the settlor is not valid. *Restatement (Third) of Trusts,* section 58(2).

3. ***Uniform Trust Code*, section 505:**

The *UTC* is in accord and provides:

> **Creditor's Claim Against Settlor**
>
> **(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:**
>
> **(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.**

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and [statutory allowances] to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses and [allowances].

(b) For purposes of this section:

(1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and

(2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in each case as in effect on [the effective date of this [Code]] [, or as later amended].

4. Colorado rule:

Newly enacted section 15-15-103 *C.R.S.* (effective July 1, 2006) establishes a clear rule in accord with the *Restatement* position concerning creditors' rights in revocable trust property postmortem. The statute says: "....(A) transferee of a nonprobate transfer (including a revocable trust) is subject to liability to any probate estate of the decedent for allowed claims against the decedent's probate estate...." [explanation added].

5. Bankruptcy:

Assets of a debtor's revocable trust are not excluded from the debtor's bankruptcy estate. 11 *U.S.C.*, section 541(b)(1).

IV. Rights of Trust Beneficiary's Creditors – General Rule:

A. **Rule of *Restatement (Third) of Trusts*, section 56:**

Rights of Beneficiary's Creditors

Except as stated in chapter 12 [spendthrift trusts and other restraints on voluntary and involuntary alienation], creditors of a trust beneficiary, or of a deceased beneficiary's estate, can subject the interest of the beneficiary to the satisfaction of their claims, except in so far as a corresponding legal interest is exempt from creditors' claims.

B. Discussion:

The rule of section 56 applies to all beneficial interests in a trust subject, of course, to spendthrift and other rules limiting alienation of beneficial interests. Such rules restricting creditor rights are set forth in Chapter 12 of the *Restatement (Third) of Trusts* and will be discussed infra.

According to this *Restatement* rule, creditors may reach a beneficiary's right to receive trust income, annuity or unitrust payments; a beneficiary's right to withdraw trust property; a beneficiary's right to discretionary distributions; and a beneficiary's future interests in the trust. *Restatement (Third) of Trusts,* section 56 cmt. a.

A creditor of a deceased beneficiary can subject the beneficiary's trust interest to the satisfaction of the creditor's claim to the extent the interest survives the beneficiary's death. *Restatement (Third) of Trusts*, section 56 cmt. c.

C. Effect – Beneficiaries:

1. Third Party Settled Irrevocable Trusts:

Unless the spendthrift rule or other restrictions on alienation apply, a beneficiary's creditors may reach the beneficiary's interest in a irrevocable trust created by others. This includes:

a. The right to trust income or to an annuity or unitrust payment. *Restatement (Third) of Trusts,* section 56 cmt. a.

b. The right to discretionary distributions, subject to the practical limitation that is the attribute of trustee discretion discussed in *Restatement (Third) of Trusts,* section 60. *Restatement (Third) of Trusts,* section 56 cmt. a.

c. The right to withdraw trust property whether of a stated or formula amount. *Restatement (Third) of Trusts,* section 56 cmts. a and b.

d. A future interest. *Restatement (Third) of Trusts,* section 56 cmt. a.

2. Third Party Settled Revocable Trusts:

a. However, with respect to revocable trusts, the creditors of a beneficiary, other than the settlor, may not reach the interest. Such a beneficiary, like a beneficiary under a will, has a mere expectancy. *Restatement (Third) of Trusts,* section 56 cmt. b.

i. Policy:

The *Restatement* recognizes the policy that treats property held in a revocable trust, the functional equivalent of a will, as the property of the settlor and not of the beneficiaries. *Restatement (Third) of Trusts,* section 56 Rptr's Notes to cmt. b; *Restatement (Third) of Trusts,* section 25.

3. Powers of Appointment:

The rights of creditors of donees of powers of appointment are determined by the nature of the power.

a. Non-general Power:

If the power may not be exercised for the donee's economic benefit, the donee's creditors may not reach the property subject to the power whether or not it is presently exercisable. *Restatement (Third) of Trusts*, section 56 cmt. b.

b. Presently Exercisable General Power:

Whether or not there is a spendthrift restraint, if the power can be exercised, presently, for the donee's economic benefit, the property subject to the power can be reached by the donee's creditors. This is so because the property subject to the power is essentially the property of the power holder. Treatment of such property is the same as treatment of property subject to a power of revocation. *Restatement (Third) of Trusts*, section 56 cmt. b. See also *Restatement (Third) of Trusts,* section 25 and *Restatement (Third) of Trusts,* section 58 cmt. b(1) and Illustration 2.

Conversely, while property of a trust over which a beneficiary holds a presently exercisable general power of appointment can be reached by the power holder's creditors, the interest of other beneficiaries can't be reached. Such non-power-holder-beneficiaries are treated as having a mere expectancy. Thus, the treatment of property subject to a presently exercisable general power of appointment is the same as property of revocable trust. *Restatement (Third) of Trusts*, section 56 cmt. b and *Restatement (Third) of Trusts*, section 58 cmt. b(1) and Illustration 2. See also *Restatement (Third) of Trusts,* section 25(2) cmt. e.

i. Policy:

The *Restatement* embraces the policy recognizing presently exercisable general powers of appointment as being property of the donee's estate. *Restatement (Third) of Trusts*, section 56 Rptr's Notes to cmt. b. See also the *Bankruptcy Code, 11 U.S.C.*, section 541(b)(1).

ii. Colorado Rule:

Compare *University National Bank v. Rhoadarmer,* 827 P.2d 561 (Colo. App. 1991) where the court held that a "5 by 5" power of withdraw (a presently exercisable general power of

appointment) was not property for purposes of attachment by the power holder's creditor (as long as property subject to the power remains in trust).

The rule announced by the Court of Appeals in *Rhoadarmer* seems incongruous with the rule recognized by the Supreme Court in *In re Cohen*, 8 P.3d 429 (Colo. 1999) affirming that a retained, discretionary interest does not escape the settlor's creditors. Under *Rhoadarmer* property subject to a withdrawal power, which power is not held in a fiduciary capacity by the power holder, is not subject to the claims of the power holder's creditors. On the other hand, a retained beneficial interest, which is subject to fiduciary discretion, is not sheltered from the beneficiary's creditors whether or not a distribution is made to the beneficiary. *Cohen*, supra at 433 (citing *Restatement (Second) of Trusts*, section 156).

c. Testamentary General Power:

Property subject to a general power of appointment exercisable only by the donee's will is not reachable by the donee's creditors during the donee's life. This is so because the donee does not have the equivalent of ownership in such property. However, the advantages of such a power are sufficiently close to beneficial ownership upon the death of the donee that the property subject to the power becomes reachable by the creditors of the donee's estate. *Restatement (Third) of Trusts,* section 56 cmt. b.

4. Self-Settled Trusts:

a. Revocable Trusts:

Whether or not there is a spendthrift provision, a creditor of the settlor who has a power of revocation may reach the trust property because, for purposes of substance as opposed to form, such trust property is essentially owned by the settlor. *Restatement (Third) of Trusts*, section 56 cmt. b; *Restatement (Third) of Trusts,* section 25 cmts. a and e. See discussion in part III, supra.

b. Irrevocable Trusts:

Under the rule of *Restatement (Third)* a spendthrift trust can not be created for the benefit of the settlor. Accordingly, whether or not

there is a spendthrift provision, the settlor's creditors can attach the settlor/beneficiary's interest. Thus, a retained right to trust income or a right to principal can be attached. *Restatement (Third) of Trusts,* section 58, cmt. e. This rule applies as well to retained discretionary interests in trusts. *Restatement (Third) of Trusts*, section 60 cmts. a and f.

D. Procedure for Reaching Beneficial Interests:

Under the *Restatement,* an attaching creditor (i.e. a creditor that is not spendthrift barred) can subject the beneficiary's interest to satisfaction of a claim. The *Restatement* says that such creditor must first attempt to satisfy the claim out of legal interests of the beneficiary unless such an attempt would be unsuccessful or insufficiently productive. The comment goes on to provide:

"In the appropriate proceedings, the court will give creditors relief that is fare and reasonable under the circumstances. If the beneficiary has only a right to the trust income or a right periodically to receive ascertainable or discretionary (but see section 60) payments, the court will normally direct the trustee to make the payments to the creditor until the claim, with interest, is satisfied. The court, however, may order less than all of the payments to be made to the creditor, leaving some distributions for the actual needs of the beneficiary and his or her family....In some circumstances, the court may order a sale of the beneficiary's interest and payment of the creditor's claim from the proceeds...." *Restatement (Third) of Trusts*, section 56 cmt. e.

1. ***Uniform Trust Code*, section 501:**

The *UTC* rule is expressed as follows:

Rights of Beneficiary's Creditor or Assignee.

To the extent a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or by other means. The court may limit the award to such relief as is appropriate under the circumstances.

2. Bankruptcy:

A beneficiary's interest that is not subject to a spendthrift provision may also be reached through federal bankruptcy proceedings (11 *U.S.C.* 541 (a)(1) and 541(c)(2). *Restatement (Third) of Trusts*, section 56 cmt. e.

E. Fraudulent Transfers:

Trusts that are created by transfers in fraud of creditors are beyond the scope of this rule. See *Restatement (Third) of Trusts*, section 29 cmt. b.

V. Forfeiture:

A. **Rule of *Restatement (Third) of Trusts*, section 57:**

Forfeiture for Voluntary or Involuntary Alienation

Except with respect to an interest retained by the settlor, the terms of a trust may validly provide that an interest shall terminate or become discretionary upon an attempt by the beneficiary to transfer it or by the beneficiary's creditors to reach it, or upon the bankruptcy of the beneficiary.

B. Discussion:

1. Termination of Beneficial Interest:

This rule recognizes that a trust may be drafted to provide for termination of the beneficial interest if the beneficiary attempts to transfer the interest; if the beneficiary attempts to pledge the interest as security; if a creditor of the beneficiary attempts to reach the interest; or if the beneficiary files for bankruptcy relief. *Restatement (Third) of Trusts,* section 57 cmt. b.

However, this rule does not apply in the case of a beneficial interest retained by the settlor. It is against the policy of the *Restatement* to allow a person by a self-settled trust to make a delayed disposition of the retained interest in the event of insolvency. *Restatement (Third) of Trusts,* section 57 Rptr's Notes to cmts. b and c.

This rule applies whether or not a spendthrift provision is contained in the trust, and whether or not a spendthrift restraint is recognized by applicable state law. *Restatement (Third) of Trusts,* section 57 Rptr's Notes to cmt. b

and c (pointing out that in England, where spendthrift provisions are not recognized, forfeiture provisions are used routinely in so called "protective trusts".)

2. Converting to Discretionary Interests:

Similarly, the terms of a trust can provide that the interest of a beneficiary (e.g. a mandatory income interest) must be converted to a purely discretionary interest in the event of an attempted voluntary or involuntary alienation. *Restatement (Third) of Trusts,* section 57 cmt. c.

3. Solvency as a Condition Precedent:

The terms of a trust can also provide that a beneficiary, other than the settlor, may be entitled to income and principal of the trust only after the beneficiary becomes financially solvent or receives a discharge in bankruptcy. *Restatement (Third) of Trusts,* section 57 cmt. d.

C. Effect:

This *Restatement* rule recognizes the validity of a trust provision that terminates a beneficial interest that is in jeopardy of attachment or assignment, or of becoming part of a beneficiary's bankruptcy estate.

Forfeiture provisions must be distinguished from spendthrift provisions. A spendthrift restraint provides that the beneficial interest may not be transferred by the beneficiary or be subject to the claims of the beneficiary's creditors. The goal of spendthrift is to perpetuate and protect the beneficial interest, not terminate it.

Forfeiture provisions, on the other hand, are designed to terminate the beneficial interest upon an attempted voluntary or involuntary alienation of the interest.

D. Policy:

Although spendthrift provisions are rejected by some states, and by the law of England, forfeiture provisions are typically recognized. It is not against public policy that the interest of a beneficiary should cease if he attempt to assign it or if his creditors attempt to attach it since the result is that he does not continue to enjoy the interest under the trust. *Restatement (Third) of Trusts,* section 57 Rptr's Notes to cmts. b and c.

E. Colorado Law:

There are no Colorado decisions or statutes addressing forfeiture of beneficial interests in trusts.

VI. Spendthrift:

A. **Rule of *Restatement (Third) of Trusts*, section 58:**

Spendthrift Trusts: Validity and General Effect

(1) Except as stated in subsection (2), and subject to the rules in cmt. b (ownership equivalence) and section 59, if the terms of a trust provide that a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid.

(2) A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of the trust is invalid.

B. Discussion:

The *Restatement* recognizes the American spendthrift rule with respect to third-party created beneficial interests. The *Restatement* rejects self-settled spendthrift trusts.

A spendthrift trust disables voluntary (i.e. assignment) and involuntary (i.e. attachment) alienation of the beneficial interest. In other words, a spendthrift restraint provides a measure of direct protection against the claims of a beneficiary's creditors.

Spendthrift restraints have been rejected by English law and by some states through case law or statutory enactments. However, the majority rule in the United States recognizes the validity of spendthrift provisions. *Restatement (Third) of Trusts,* section 58 cmt. a.

1. Compare Discretionary Trusts:

A discretionary trust is indirectly protective against creditor claims because, even though a beneficiary's creditor can attach the discretionary interest

(assuming there is no spendthrift restraint), as a general rule the creditor can't force exercise of discretion because the beneficiary can't either. *Restatement (Third) of Trusts,* section 60 cmt. e. See discussion on discretionary interests in part VIII, infra.

2. Bankruptcy and Other Federal Statutes:

The Bankruptcy Code provides that a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under the Bankruptcy Code. *11 U.S.C.*, section 541(c)(2). See also the *Employment Retirement and Income Security Act* (*ERISA*) at section 206(d)(1) which requires spendthrift protection for the employees' benefits.

The Internal Revenue Code recognizes the validity of spendthrift provisions in the terms of marital trusts and therefore does not disqualify such trusts from the marital deduction. *Treas. Reg.*, section 20.2056(b)-5(f)(7).

However, inclusion of a forfeiture provision does disqualify such trusts for the marital deduction. *Virginia National Bank v. United States,* 443 F.2d 1030 (4th Cir. 1971).

3. Colorado Law:

This state recognizes the validity of spendthrift trusts in case law. *Snyder v. O'Conner,* 81 P.2d 773 (1938); *Newell v. Tubbs*, 84 P.2d 820 (1938); *Brasser v. Hutchinson*, 549 P.2d 801 (Colo. App. 1976); *In re Portner,* 109 B.R. 977(Bankr. D. Colo.) (a spendthrift trust was valid under Colorado law and therefore the debtor's trust interest was not property of the bankruptcy estate).

4. ***Uniform Trust Code*, section 502:**

The *Uniform Trust Code* would codify the validity of spendthrift provisions. *UTC,* section 502 provides:

Spendthrift Provision

(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficial interest.

(b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.

(c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

C. Requirements for a Valid Spendthrift Provision:

The *Restatement* contains a lengthy discussion of the several requirements to create a valid spendthrift provision.

1. Self-Settled Spendthrift Trusts Rejected:

The "black letter law" rejects self-settled spendthrift trusts. Accordingly, any interest retained by the settlor, whether current or future, and whether discretionary or not, is subject to attachment by the settlor's creditors. Furthermore, if the settlor is the sole beneficiary during life and reserves a general power of appointment, even a testamentary general power, creditors of the settlor can reach not only the beneficial interest retained for life but the trust property itself. *Restatement (Third) of Trusts*, section 58 cmts. b and e.

a. Bankruptcy:

This self-settled trust rejection rule is in accord with the Federal Bankruptcy Act which provides that a beneficial interest in a trust that is not subject to restriction on transfer enforceable under applicable non-bankruptcy law passes to the beneficiary's bankruptcy estate. 11 *USC*, section 541(c)(2).

b. Colorado Law:

Section 38-10-111 *C.R.S.* provides that:

"All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the

use of the person making the same shall be void against the creditors existing of such person." [Emphasis added.]

It has been suggested that this Colorado statute may allow creation of self-settled trusts that are insulated from the claims of future creditors of the settlor. See for example, *In re Baum* 22 F.3d 1014 (10th Cert. 1994). This theory has been discussed and rejected by the Colorado Supreme Court, in dicta, in *In re Cohen*, 8 P.3d 429 (Colo. 1999). In suggesting that it is not possible to create self-settled spendthrift trusts in Colorado, the Supreme Court cited the traditional trust doctrine embraced in *Restatement (Second) of Trusts*, section 156 (1959). The *Restatement (Third) of Trusts* position is in accord with the *Restatement (Second)* position.

See also *Kaladic v. Kaladic*, 589 P.2d 502 (Colo. App. 1978) holding that self-settled, irrevocable spendthrift trusts are illusory.

c. ***Uniform Trust Code,* section 505:**

The *Uniform Trust Code* follows traditional trust doctrine in providing that whether or not the trust contains a spendthrift restraint, a creditor of the settlor/beneficiary may reach the maximum amount that the trustee could have paid to the settlor/beneficiary. The applicable *UTC* provision is section 505(a) which provides, in relevant part:

Creditor's Claims Against Settlor

(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to the claims of the settlor's creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit....

(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and [statutory allowances] to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses and [allowances].

*****

d. Asset Protection Jurisdictions:

Restatement (Third), the *Uniform Trust Code*, and apparently Colorado, reject the approach taken in the six so-called domestic asset protection jurisdictions, namely Alaska, Delaware, Rhode Island, Nevada, Utah and South Dakota. In these states it is possible to create a self-settled trust that is insulated from the claims of the settlor's creditors. See Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part 1*, 40 Real Prop. Prob. & Tr. J. 271 (2005).

2. Ownership Equivalence Unaffected:

An intended spendthrift restraint is also invalid with respect to a non-settlor's interests in trust property over which the beneficiary has the equivalent of ownership. Thus, if such a beneficiary holds a presently exercisable general power of appointment, a spendthrift restraint will not prevent the beneficiary's creditors from reaching the property that is subject to the power because the beneficiary has power to demand immediate possession of the property subject to the power. Distinguish such a power from a general power of appointment exercisable only at death which does not give the non-settlor/beneficiary the equivalent of ownership during life. *Restatement (Third) of Trusts*, section 58, cmt. b(1).

a. "Ownership Equivalence":

If a non-settlor/beneficiary has the power to demand immediate distribution of the trust property, or if the non-settlor/beneficiary has a general power of appointment over the trust property, or if such

person is at once the sole the beneficiary and sole trustee, the beneficiary is in effect the "owner" of the property for purposes of the *Restatement*. This is referred to frequently in the *Restatement* and in this paper as "equivalence of ownership."

i. Compare *University National Bank v. Rhoadarmer*, supra, holding that property subject to a withdrawal power cannot be reached by the power holder's creditors.

3. Restraint on Both Voluntary and Involuntary Alienation:

To be effective under the *Restatement* rule, a spendthrift trust must restrain both voluntary (assignment) and involuntary (attachment) alienation. *Restatement (Third) of Trusts*, section 58 cmt. b(2).

a. Colorado Law:

This rule is in accord with existing Colorado case law. *Snyder* and *Newell*, supra.

b. *Uniform Trust Code*:

The *UTC* rule is also in accord with the *Restatement* position. *UTC*, section 502(b).

4. Manifestation of Intent:

A settlor must manifest an intent to create a spendthrift trust. Under the *Restatement* rule, no particular form of wording is necessary for this purpose as long as the requisite intention can be discerned from the terms of the trust. For example, it is sufficient if a settlor simply provides that the trust "is to be a spendthrift trust." *Restatement (Third) of Trusts*, section 58 cmt. b(3).

a. Colorado Law:

The Colorado spendthrift rule recognized in *Snyder* and *Newell*, supra, requires detailed drafting to manifest an intent to create a spendthrift provision. Accordingly, a valid spendthrift trust in Colorado requires the terms of a spendthrift trust to include language substantially as follows:

> During the continuation of this trust, no beneficiary of the trust estate shall have the right to anticipate, sell, assign, mortgage, pledge, or otherwise dispose of or encumber his or her share of the trust estate, or any part thereof, or any interest therein; or his or her share of the income arising therefrom, or any part thereof, or any interest therein; nor shall such share of the trust estate or of the income arising therefrom be liable for his or her debts or be subject to attachment, garnishment, execution, creditor's bill or other legal or equitable process. *Snyder*, supra at 774.

b. *Uniform Trust Code*:

If the *UTC* is enacted in Colorado, there will be a relaxation of this rule. The *UTC*, like the *Restatement*, would allow creation of a valid spendthrift trust by simply using the words "spendthrift trust" or words of similar import. Use of such words would incorporate into the trust a restraint on both voluntary and involuntary transfer of the beneficiary's interest. *UTC*, section 502(b).

D. Effect:

1. Spendthrift Restraint and Creditors:

A spendthrift trust provides only limited protection against the beneficiary's creditors because the protection does not extend beyond the point of distribution. Thus, a spendthrift trust protects the income and principal interests of its beneficiaries from the claims of their creditors so long as the income or principal in question is property held in the trust. Such property cannot be attached by judgment creditors of the beneficiary, nor does such property become an asset of the beneficiary's bankruptcy estate. However, after the income or principal of a spendthrift trust has been distributed to the beneficiary, it can be reached by creditors through the same procedures and in accordance with the same rules that apply generally to property of a debtor. In addition, property that has become distributable to a beneficiary but that is retained by the trustee beyond a time reasonably necessary to make distribution, it is subject to attachment. *Restatement (Third) of Trusts,* section 58, cmt. d(2); see also the *Uniform Trust Code*, section 506 governing overdue distributions and the discussion, infra.

2. Distributions for Benefit of a Debtor/Beneficiary:

Trust instruments commonly authorize trustees to make distributions to or for benefit of the beneficiaries. To the extent the terms of the trust so provide, such provisions will be given effect unless contrary to public policy. *Restatement (Third) of Trusts*, section 49 cmt. a.

But what if the terms of the trust only authorize distributions to the beneficiary? May a trustee nonetheless make protective distributions for benefit of the beneficiary? The *Restatement* appears to contemplate such distributions although not in the context of creditor's rights. The *Restatement* provides that a "trustee who improperly applies or distributes income in good faith for the support, care, or other needs of the beneficiary (whether or not under a legal disability) is entitled to a credit in the trust accounts to the extent the beneficiary would otherwise be unjustly enriched." *Restatement (Third) of Trusts*, section 49 cmt. c(2). Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J., 567, 570, 2005.

a. *Uniform Trust Code*:

The *UTC* would provide a more definite and protective rule in this context. *UTC*, section 502(c) provides that "a creditor... of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary." Because a distribution to a third party for benefit of the beneficiary would never be in the hands of the beneficiary, the beneficiary's creditors presumably would not be able to attach it. Although *UTC*, section 501 authorizes creditors of a beneficiary "to reach the beneficiary's interest by attachment of present or future distributions to or for benefit of the beneficiary," it applies only to "the extent a beneficiary's interest is not subject to a spendthrift provision." *UTC*, section 501 cmts. Presumably, the *UTC* authorizes the trustee to make protected distributions to third parties for benefit of a debtor beneficiary if the terms of the trust authorize such third party distributions. But what if the terms of the trust don't allow third party distributions for benefit of the beneficiary? The *UTC* may authorize such distributions for two reasons: (*i*) *UTC*, section 1009 would presumably protect the trustee from liability in such circumstances where there is a consent, release or ratification by the beneficiary of the trustee's conduct; and (*ii*) where the beneficiary is incapacitated, *UTC*, section 816(21) empowers the trustee to apply trust income and principal for the beneficiary's benefit. These *UTC* provisions, in conjunction with *Restatement (Third) of Trusts*,

section 49 would presumably allow protected third party distributions even though they are not expressly unauthorized by the terms of the trust. Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J. 567, 570, 2005.

E. Overdue Distributions:

1. *Restatement (Third)*:

The existence of a valid spendthrift restraint is immaterial with respect to trust property that has become distributable to the beneficiary but is retained by the trustee beyond a time reasonably necessary to make the distribution. *Restatement (Third) of Trusts*, section 58 cmt. d(2).

2. ***Uniform Trust Code*, section 506:**

This *Restatement* rule is similar to the rule of *UTC*, section 506 which provides:

> **Overdue Distribution:**
>
> **(a) In this section, "mandatory distribution" means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.**
>
> **(b) Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date.**

VII. Exceptions to Spendthrift: ***Restatement (Third) of Trusts*, section 59:**

A. Policy:

The history of the uniquely American spendthrift rule and public policy considerations shaping the modern rule are set forth in *Restatement (Third) of Trusts,* section 58 Rptr's Notes to cmt. a. The following discussion is a summary of the Reporter's Notes.

A spendthrift trust is void in England as being against public policy and as creating an unlawful restraint on alienation. *George T. Bogert - Trusts,* section 40 (Hornbook, 6th ed. 1987).

However, spendthrift trusts are valid in almost all jurisdictions in the United States.

According to Dean Griswold, the greatest single factor in the development of spendthrift trusts in America was the dictum of Mr. Justice Miller in *Nichols v. Eaton,* 91 U.S. 716 (1875). Justice Miller observed that "why a parent...who...wishes to use his own property in securing [his child]...from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self protection, should not be permitted to do so is not readily perceived." Erwin N. Griswold, *Spendthrift Trusts,* section 29 (2d. ed., 1947).

In a subsequent decision it was held that "an owner of property, having the entire right to dispose of his property, may settle it in a trust in favor of another and may provide that it shall not be alienated by him by anticipation, and shall not be subject to be seized by his creditors in advance of its payment to him....". *Broadway National Bank v. Adams,* 133 Mass. 170, 43 Am.Rep.504(1882).

After discussing the above decisions, Dean Griswold demonstrates that the rule is patently fallacious because of the numerous restrictions on the "deadhand" that exist apart from the spendthrift rule, e.g. forced heirship, rules relating to perpetuities, prohibitions against trusts with indefinite beneficiaries, illegal purposes or unreasonable restraints on marriage or that encourage divorce or neglect of duties, and rules prohibiting restraints on alienation of legal interests. Dean Griswold then says:

> "...the bundle of rights known as ownership of property does not embrace an unqualified power of disposition in any way desired. There is no syllogistic basis for the spendthrift trust. If such trusts are valid it is not because the owner of property may dispose of it as he sees fit, but because the particular restriction in question is not contrary to public policy. The

question therefore involves an examination of public policy..." Erwin N. Griswold, *Spendthrift-Trusts*, sections 32, 552-555 (2d ed.1947).

B. **Rule of *Restatement (Third) of Trusts*, section 59:**

Spendthrift Trusts: Exceptions for Particular Types of Claims:

The interest of a beneficiary in a spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for:

a) Support of a child, spouse or former spouse; or

b) Services or supplies provided for necessities or for protection of the beneficiary's interest in the trust.

C. Discussion:

The rule stated in section 59 recognizes that certain categories of creditors may, for public policy reasons, reach beneficial interests in spendthrift trusts. In other words, that freedom of disposition in the United States allows a property owner to impose conditions and limitations on beneficial interests he or she creates in a trust, but only to the extent they are not illegal or contrary to public policy. *Restatement (Third) of Trusts*, section 59 cmt. a and Rptr's Notes on cmt. a. See also *Restatement (Third) of Trusts,* section 29 governing trust provisions that are illegal or contrary to public policy and discussion in part II, supra.

D. Exceptions:

1. Expressed Exceptions:

a. Support Claims:

The *Restatement* expressly provides that a beneficial interest in a spendthrift trust can be reached to satisfy an enforceable claim by the beneficiary's spouse or children for support, and by the beneficiary's former spouse for support or alimony.

The beneficiary's interest may be attached through an appropriate proceeding in which the court has equitable discretion to determine whether all or only a portion of the trust distributions should be

allocated to the support claimant, taking into account the beneficiary's actual need for some part of the distributions. *Restatement (Third) of Trusts,* section 59 cmt. b.

Notwithstanding this spendthrift preferred creditor status, such creditors' rights cannot be anticipated by execution sale. *Restatement (Third) of Trusts,* section 59 cmt. b. However, a beneficial interest, other than a discretionary interest, not protected by a spendthrift restraint can be sold at judicial sale. *Restatement (Third) of Trusts,* section 56 cmt. e. Discretionary interests are not subject to sale and satisfaction of a claim. *Restatement (Third) of Trusts,* section 60 cmt. c.

i. Policy:

The beneficiary should not be permitted to enjoy a beneficial interest in a trust while neglecting the support of dependants. *Restatement (Third) of Trusts*, section 59 cmt. b. See also *Restatement (Third) of Trusts*, section 50 cmt. d(2).

b. Debts Incurred for Beneficiary's Necessities:

The interest of a beneficiary of a spendthrift trust can be reached to satisfy an enforceable claim by one, such as a physician, who renders necessary services or furnishes necessary supplies to the beneficiary. *Restatement (Third) of Trusts,* section 59 cmt. c.

i. Policy:

Failure to give enforcement to appropriate claims of this type would tend to undermine the beneficiary's ability to obtain necessary goods and assistance. *Restatement (Third) of Trusts*, section 59 cmt. c.

c. Debts Incurred to Protect Beneficiary's Interest:

The interest of a beneficiary in a spendthrift trust can be reached to satisfy an enforceable claim for services rendered (such as by an attorney) or materials furnished to the beneficiary for the purpose of preserving his or her beneficial interest. *Restatement (Third) of Trusts*, section 59 cmt. d.

i. Policy:

The beneficiary in these cases would be unjustly enriched if the claimant were prevented from reaching the beneficial interest; and a beneficiary of modest means would find the spendthrift restraint an obstacle to obtaining services essential to protection or enforcement of his or her rights under the trust. *Restatement (Third) of Trusts,* section 59 cmt. d.

2. Implicit Exceptions:

a. Governmental Claims:

It is implicit in the rule of section 59 that governmental claimants, and other claimants as well, may reach the interest of a beneficiary of a spendthrift trust to the extent provided by federal law or an applicable state statute. Governmental claims and claims under governmentally assisted programs are often granted this special status. Stated another way, the *Restatement* acknowledges the preemption of state law by federal law and of common law rules by state legislation. *Restatement (Third) of Trusts,* section 59 cmt. a(1) and Rptr's Notes on cmts. a-a(2).

b. Other Exceptions Possible:

The *Restatement* takes the position that exceptions to spendthrift immunity stated in section 59 are not exclusive. Special circumstances or evolving public policy may justify recognition of other exceptions allowing the beneficiary's interest to be reached by certain creditors in appropriate proceedings. *Restatement (Third) of Trusts*, section 59 cmt. a(2).

i. Tort claims:

In fact, such an exception was recognized by the Supreme Court of Mississippi in *Sligh v. First National Bank*, 704 So.2d 1020 (Miss. 1997) (it is against public policy to dispose of property in such a way that the beneficiary may enjoy the income from such property without fear that his interest may be attached to satisfy claims for his gross negligence or intentional torts). The decision in *Sligh* was subsequently overruled by legislation but the court's rational might be followed in other jurisdictions.

E. ***Uniform Trust Code*, section 503:**

1. Section 503 of the *UTC* codifies some but not all of the *Restatement* exceptions to spendthrift.

> **Exceptions to Spendthrift Provision**
>
> **(a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.**
>
> **(b) To the extent provided in subsection (c), a spendthrift provision is unenforceable against:**
>
> **(1) A beneficiary's child, spouse or former spouse who has a judgment or court order against the beneficiary for support or maintenance;**
>
> **(2) A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and**
>
> **(3) A claim of this State or the United States to the extent a statute of this State or federal law so provides.**
>
> **(c) The only remedy of a claimant against whom a spendthrift provision cannot be enforced is to obtain from a court an order attaching present or future distributions to or for benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances.**

2. Certainty of *UTC* rule:

As discussed above, *Restatements* are summaries of the common law on particular subjects. While *Restatements* are perhaps persuasive, courts are free to deviate from the *Restatement* position. On the other hand, a statute, such as the *Uniform Trust Code*, is binding on courts in the enacting jurisdictions.

Thus, while *Restatement (Third)* leaves open the possibility that courts may recognize other exceptions to spendthrift protection, such as for a tort creditor, enactment of the *UTC* will prevent courts from doing so. The *UTC* provides that creditors may not reach a beneficial interest in a spendthrift trust "except as otherwise provided" in the Code. *Uniform Trust Code,* section 502(c) and cmt. Thus, enactment of the *UTC* will limit the classes of exception creditors to those recognized by the legislature.

It is noteworthy that the *UTC* rejects spendthrift exception status for creditors who have provided "necessities" for support of the beneficiary.

G. Colorado Law:

There is no Colorado case recognizing or refusing to recognize exceptions to the spendthrift rule. However, as Kevin Millard has suggested, it is reasonable to assume Colorado courts, when presented with these issues, will follow the *Restatement* position. Kevin D. Millard, *The Uniform Trust Code*, p. 26 and Appendix C (November 2004).

VIII. Discretionary Interests:

A. **Rule of *Restatement (Third) of Trusts*, section 60:**

Transfer or Attachment of Discretionary Interests

Subject to the rules stated in sections 58 and 59 (on spendthrift trusts), if the terms of a trust provide for a beneficiary to receive distributions in the trustee's discretion, a transferee or creditor of the beneficiary is entitled to receive or attach any distributions the trustee makes or is required to make in the exercise of that discretion after the trustee has knowledge of the transfer or attachment. The amounts a creditor can reach may be limited to provide for the beneficiary's needs (Comment c), or the amounts may be increased where the beneficiary is either the settlor (Comment f) or holds the discretionary power to determine his or her own distributions (Comment g).

B. Discussion:

This rule allows a beneficiary's creditor to attach his or her discretionary interest. This rule also puts the trustee at personal risk in making distributions to the beneficiary or to a third party on behalf of the beneficiary after the trustee has knowledge of an attachment. *Restatement (Third) of Trusts,* section 60 cmt. a.

This rule does not apply if the beneficiary's interest is subject to a valid spendthrift restraint (*Restatement (Third) of Trusts*, section 58) unless the situation falls under an exception to spendthrift (*Restatement (Third) of Trusts,* section 59). *Restatement (Third) of Trusts,* section 60 cmt. a.

In a departure from *Restatement (Second) of Trusts*, the rule of this *Restatement* applies to discretionary interests whether expressed in the form of a standard or not. Compare *Restatement (Second) of Trusts,* section 154 (support trusts) and *Restatement (Second) of Trusts,* section 155 (discretionary trusts). "The so-called 'support trust,' for example, is viewed here (the *Restatement (Third)*) as a discretionary trust with a support standard. This in turn requires asking and examining all of the questions that follow from that view, such as how a particular standard, in context, is to be interpreted...in making a fiduciary judgment about appropriate distributions to the beneficiary....Not only is the supposed distinction between support and discretionary trust arbitrary and artificial, but the lines are also difficult - and costly - to attempt to draw....In addition, as far as creditors are concerned, the result of the traditional *Restatement* formulations and rules is that either the trust is a 'discretionary trust,' under which the transferee or creditor cannot compel the trustee to pay anything to him because the beneficiary could not compel payment to himself or application for his own benefit (*Restatement (Second) of Trusts,* section 155, cmt. b) or it is a 'support trust,' in which case the transferee or creditor cannot compel the trustee to pay anything to him, because the beneficiary could not except for the restricted purpose (*Restatement (Second) of Trusts*, section 154, cmt. b)...." *Restatement (Third) of Trusts*, section 60 cmt. a. and Rptr's Notes on cmt. a.

1. Colorado law:

   Accord in *In re Marriage of Jones*, 812 P.2d, 1152 (Colo. 1991): "The fact that trustees are limited to disbursing funds to the wife for only her support, if they decide to disburse funds at all, does not deprive the trust of its discretionary character." *Jones* at 1156.

The rule of section 60 means that attaching creditors (no spendthrift protection applies) may subject the discretionary interest to satisfaction of their claims by appropriate process described in *Restatement (Third) of Trusts*, section 56 cmt. e.

The discretionary interest is not, however, subject to execution sale. *Restatement (Third) of Trusts,* section 60 cmt. c.

If spendthrift does not apply and if the trustee has been served by process in a proceeding by an attaching creditor, the trustee is personally liable to the creditor for any amount paid to or applied for benefit of the beneficiary. *Restatement (Third) of Trusts,* section 60 cmt. c.

However, the analysis of creditor rights does not end here. The "black letter" rule of section 60 mandates that "...The amounts a creditor can reach may be limited to provide for the beneficiary's needs...." Thus, a trustee's refusal to make distributions might not constitute an abuse as against a creditor because the extent to which a designated beneficiary might actually benefit from a distribution is relevant to the justification and reasonableness of the trustee's decision in relation to the settlor's purposes and the effects on other beneficiaries. The balancing process typical of discretionary issues becomes significantly weighed against creditors. *Restatement (Third) of Trusts,* section 60 cmt. e.

1. Special Rules:

   a. Self-Settled Trusts:

      Where the trustee of an irrevocable trust has discretionary authority to distribute to or for benefit of the settlor, creditors of the settlor can reach the maximum amount the trustee, in the proper exercise of discretion, could distribute to or for benefit of the settlor. *Restatement (Third) of Trusts,* section 60 cmt. f.

   b. Trustee/Beneficiary:

      Where the discretionary beneficiary is also trustee (e.g. the spouse/beneficiary/trustee of a bypass trust), his or her creditors are able to reach the maximum amount the trustee/beneficiary can properly take. As in other non-settlor-beneficiary situations, the court may reserve a portion of the amount for the reasonable support, etc., of the beneficiary. *Restatement (Third) of Trusts*, section 60 cmt. g.

      i. Policy:

         The beneficiary's rights in these circumstances represents a limited form or ownership equivalence analogous to certain general powers of appointment. *Restatement (Third) of Trusts,* section 60 cmt. g; *Restatement (Third) of Trusts,* section 56 cmt. b; *Restatement (Third) of Trusts,* section 25(2).

But see *Restatement (Third) of Trusts,* section 58 cmt. b(1) which also discusses absence of "ownership equivalence" as one of the requirements for a valid spendthrift restraint which says, without further explanation, that: "....Except in [the case of merger] a spendthrift provision is not invalid with respect to a beneficiary's interest merely because the beneficiary is also the trustee or co-trustee."

ii. Distinguish Tax Rules:

It must be observed that this property law rule is to be distinguished from the familiar tax rules relied upon in structuring traditional family/bypass trust plans for benefit of the surviving spouse and under which the surviving spouse serves as trustee (e.g. IRC, sections 2041 and 2514). Given the different policies and considerations involved in creditor's rights situations, such tax statutes, and their rules are of limited relevance and not viewed as controlling in a property law context. *Restatement (Third) of Trusts,* section 60 Rptr's Notes on cmt. g.

iii. *Uniform Trust Code*:

Believing that the rule of *Restatement (Third) of Trusts* 60 cmt. g. would unduly disrupt standard family/bypass trust planning, NCCUSL added subsection (e) to section 504 in 2005. The 2005 amendment provides:

> **Discretionary Trusts; Effect of Standard**
>
> ****
>
> **(e) If the trustee's or co-trustee's discretion to make distributions for the trustee's or co-trustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or co-trustee.**

Thus, under the *UTC* rule, a beneficiary/trustee is protected from creditor claims to the extent the beneficiary/trustee's discretion is limited by an ascertainable standard as defined in relevant Internal Revenue Code sections. In other words, the beneficiary/trustee's interest is protected to the extent it is also insulated from federal estate tax. The intent of this amendment is to protect the trustee/beneficiary of a traditional family/bypass trust from creditor claims. *Uniform Trust Code,* section 504 cmt.

C. Compelling Discretionary Distributions:

As a general rule, a creditor of a beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary cannot do so. However, this *Restatement* points out that it is rare that the beneficiary is so powerless taking into account: (i) the beneficiary's circumstances; (ii) the terms of the discretionary power; (iii) and the purposes of the trust. Thus the exercise or non-exercise of discretion is always subject to judicial review to prevent abuse. *Restatement (Third) of Trusts*, section 50 cmt. b; *Restatement (Second) of Trusts*, section 187; *In re Marriage of Jones*, 812 P.2d 1152, 1156 (Colo. 1991).

Restatement (Third) of Trusts, section 60 cmt. e goes on to provided that: "....What might constitute an abuse, however, is not only affected by the extent of the trustee's discretion, standards applicable to its exercise, and purposes of the trust, but also by the beneficiary's circumstances and the effect discretionary distributions will have on the discretionary beneficiary and on others in relation to the fulfillment of trust purposes....The rights of a discretionary beneficiary's assignee or creditor are also entitled to judicial protection from abuse of discretion by the trustee. On the other hand, a trustee's refusal to make distributions might not constitute an abuse against an assignee or creditor....This is because the extent to which the designated beneficiary might actually benefit from a distribution is relevant to the justification and reasonableness of the trustee's decision in relation to the settlor's purposes and the effects on other beneficiaries....Thus, the balancing process typical of discretionary issues becomes, in this context, significantly weighted against creditors, and sometimes against an beneficiary's voluntary assignees." *Restatement (Third) of Trusts,* section 60 cmt. e. [underscoring added]

1. Special Claimants:

A handful of cases in other states recognize rights of certain creditors of discretionary beneficiaries in certain circumstances.

a. Claims for Necessities Provided:

The *Restatement* position holds that a creditor who has provided services or materials either for the protection of the beneficiary's interest in the trust or deemed necessary for the beneficiary's support or care should be able to compel a trustee to make distribution for those goods and services when it would be an abuse of discretion for the trustee not to do so. *Restatement (Third) of Trusts,* section 60 cmt. e(1); *Estate of Dodge*, 281 N.W. 2d. 447 (Iowa 1979). See also cases cited in *Restatement (Third) of Trusts,* section 60 Rptr's Notes on cmts. e and e(1).

b. Claims for Support Owed:

A creditor seeking to enforce a support right or judgment against the trust beneficiary may be able to compel the trustee to make a distribution on the ground that refusal to do so would constitute an abuse of discretion. Furthermore, a beneficiary's right to distributions for "support" usually includes amounts appropriate to the support of certain dependents. *In re Sullivan's Will,* 12 N.W. 2d. 148 (Neb. 1943). See also cases cited in *Restatement (Third) of Trusts,* section 60 Rptr's Notes on cmts. e and e(1). See also the constructional standards that include the spouse, children and former spouse within the scope of a trustee's discretion to make support distributions to or for benefit of a beneficiary. *Restatement (Third) of Trusts,* section 50 cmt. d(2).

i. Extended discretion (see discussion re: section 50, infra):

If the settlor granted trustee extended discretion (e.g., "unlimited", "absolute", or "uncontrolled" discretion) with respect to a support standard, would such "special claimants" be prevented from forcing exercise of discretion? Possibly.

Absent words of extended discretion, a court will intervene if it finds the payments made or not made to be unreasonable as a means of carrying out the trust's provisions. *Restatement (Third) of Trusts,* section 50 cmt. b.

> While it is against sound policy to permit the settlor to relieve a trustee of all accountability, use of words of extended discretion manifests an intention to relieve the trustee of normal judicial supervision and control in exercise of discretion. *Restatement (Third) of Trusts,* section 50 cmt. c.
>
> Thus, use of terms of extended discretion in the trust might lead to an interpretation granting the trustee ordinary discretion with respect to the beneficiary (reasonable support) with more latitude applicable to the trustee's exercise of discretion with respect to others. *Restatement (Third) of Trusts*, section 50 cmt. c.

2. Expanded Creditor Rights Issue:

Some lawyers have argued that *Restatement (Third) of Trusts*, section 60 cmt. e (cited almost verbatim above) creates new law in giving creditors enforceable rights in discretionary trusts. This is not true. As pointed out above, cases in some jurisdictions already allow certain creditors (i.e. creditors with support claims against the beneficiary and creditors who have supplied the beneficiary with necessities for support and care) to seek court review of a trustee's exercise of discretion especially when the terms of the trust include a support standard. *Estate of Dodge*, supra; *In re Sullivan's Will,* supra; and cases cited in *Restatement (Third) of Trusts*, section 60 Rptr's Notes on cmts e and e(1).

Even though comment e(2) of section 60 recognizes that a beneficiary's creditor is in some circumstances entitled to judicial protection against abuse, the comment also provides that a trustee's exercise of discretion might not be actionable by a creditor in circumstances when it would [redacted] be actionable by the beneficiary. The explanation for the difference in treatment is that:

> "....the extent to which the designated beneficiary might actually benefit from a distribution is relevant to the justification and reasonableness of the trustee's decision in relation to the settlor's purposes and the effects on other beneficiaries....Thus, the balancing process typical of discretionary issues, becomes, in this context, significantly weighted against creditors....Cf *Restatement*

(Third) of Trusts, section 60 cmt. e. See Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J. 567, 586, 2005.

Thus, the *Restatement* position seems to be more restrictive and sensitive to beneficial interests than, perhaps, the common law position in certain states. See *Estate of Dodge*; *In re Sullivan's Will*; and discussion, supra.

3. ***Uniform Trust Code*, section 504 provides:**

Discretionary Trusts; Effect of Standard

(a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.

(b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:

(1) The discretion is expressed in the form of a standard of distribution; or

(2) The trustee has abused discretion.

(c) To the extent a trustee has not complied with the standard of distribution or has abused discretion:

(1) A distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse or former spouse; and

(2) The court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

(d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.

(e) If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.

The rule of the *Uniform Trust Code* is more protective of discretionary interests. The *UTC* makes it clear that even if there is no spendthrift provision in the trust terms, with one exception, no creditor of a beneficiary can compel a distribution that is subject to the trustee's discretion whether such discretion is expressed in the form or a standard or not, and even if the trustee has abused discretion.

a. Claim for Necessities for Support of Beneficiary:

The *UTC* position is clear. No creditor of a beneficiary may compel discretionary distributions. Even if the trust is a support trust and the creditor has a claim for support provided to the beneficiary, that creditor, even if it is the State, may not compel discretionary distributions to satisfy the claim. The existence of a spendthrift provision is immaterial. *Uniform Trust Code,* section 504 cmt.

b. Claim for Spouse/Child for Support:

Under *UTC,* section 504(c) a court may order discretionary distributions to the beneficiary's child, spouse or former spouse. Whether or not there is a spendthrift provision is immaterial. However, there are limitations on the ability of these creditors to compel discretionary distributions that they can reach, to wit: *(i)* the creditor must have a judgment or court order against the beneficiary for support or maintenance; *(ii)* the *UTC* does not require, but merely authorizes, the court to satisfy such a judgment or court order; *(iii)* such an order may be entered only to the extent a trustee has abused discretion; and *(iv)* the court must direct the trustee to distribute to the

creditor only an amount that is equitable taking into account the beneficiary's circumstances. Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J., 567, 588, 2005.

4. Colorado Law:

There are no Colorado cases defining creditors' rights in discretionary trusts.

a. The Decision in *Jones*:

Some Colorado lawyers cite *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991) in support of their proposition that in Colorado, beneficial interests in discretionary trusts are insulated from the claims of the beneficiary's creditors. However, the Supreme Court did not address the issue of creditor's rights in *Jones*. The case involved division of marital property and whether a spouse's discretionary interest in a third-party settled trust was "property" for purposes of division of property under section 14-10-113 *C.R.S.* In concluding that the particular discretionary interest was not "property" for such purposes, the Supreme Court focused primarily on the rule that a discretionary beneficiary cannot compel exercise of discretion and, accordingly, the interest was not "property" for purposes of divorce. This is the rule of *Restatement (Third) of Trusts*, section 50. The *Jones* case and *Restatement (Third)* recognize that a discretionary beneficiary always has the right to seek court review to prevent abuse. *Jones*, supra at 1156; *Restatement (Third) of Trusts*, section 50 cmt. b.

The Supreme Court in *Jones* did not address if and under what circumstances a child, spouse, or former spouse with a judgment for support could reach the assets of a discretionary trust to satisfy the judgment. See further discussion of *Jones*, and section 50, infra.

IX. Enforcement of Discretionary Interests:

A. **Rule of *Restatement (Third) of Trusts*, section 50:**

Enforcement and Construction of Discretionary Interests:

(1) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial

control only to prevent misinterpretation or abuse of the discretion by the trustee.

(2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.

B. Discussion:

The power of a trustee and the discharge of a trustee's responsibility typically involve the exercise of discretion. Courts will interfere with a trustee's exercise of discretion only to prevent abuse. *Restatement (Third) of Trusts,* section 50 cmt. a.

Thus, a discretionary beneficiary can't compel exercise of discretion. However, court intervention may be obtained to rectify abuses resulting from bad faith or improper motive, to correct errors resulting from mistakes of interpretation, or where a trustee fails to exercise discretion at all. *Restatement (Third) of Trusts*, section 50 cmt. b.

What constitutes an abuse of discretion depends upon the terms of the trust, as well as on basic fiduciary duties and principles. Of particular importance in this analysis are: *(i)* the purposes of the discretionary power; *(ii)* the standards applicable to the exercise of discretion; and *(iii)* the extent of discretion conferred upon the trustee. *Restatement (Third) of Trusts,* section 50 cmt. b and cmts. d through f.

The trustee may have discretion whether or not to make distributions to a beneficiary or the trustee may have discretion as to the time, manner and amount of distributions pursuant to a particular standard. *Restatement (Third) of Trusts*, section 50 cmt. a.

Absent language conferring extended discretion to the trustee, a court will also intervene if it finds that the trustee has acted unreasonably. *Restatement (Third) of Trusts,* section 50 cmt. b.

1. Extended Discretion – The *Restatement (Third)* rule:

Although a grant of discretion does not ordinarily authorize a trustee to act beyond the bounds of reasonable judgment, a settlor may manifest an intent to grant greater than ordinary latitude in exercising discretion. *Restatement (Third) of Trusts,* section 50 cmts. c and d.

Terms such as "sole", "absolute", and "uncontrolled", grant to the trustee greater than ordinary latitude in exercising discretionary judgment. *Restatement (Third) of Trusts,* section 50 cmt. c.

a. Unlimited Discretion Disallowed:

Once it is determined that a trust relationship has been established, words of extended discretion are not to be interpreted literally. Even under the broadest grant of discretion, a trustee must act honestly and in a state of mind contemplated by the settlor. Thus, a court must not permit a trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power. And, a court must also prevent the trustee from failing to act or acting arbitrarily or from a misunderstanding of the trustee's duty or authority. *Restatement (Third) of Trusts*, section 50 cmt. c.

b. Effect:

Extended discretion may make it difficult for a discretionary beneficiary to obtain judicial intervention when a trustee's exercise of discretion is highly conservative with regard to matters that fall within the settlor's authorized purposes. *Restatement (Third) of Trusts,* section 50 cmt. c.

2. Extended Discretion – Traditional Rule:

The *Restatement (Third)* position is in accord with traditional common law principles which hold that a settlor is not allowed to confer unlimited discretion upon the trustee.

> "It is against public policy to permit the settlor to relieve the trustee of all accountability....It is true that the powers conferred upon the transferee of property may be so extensive as to indicate an intent not to create a trust but to give the beneficial interest in the property to the transferee....If, however, a trust is created, it is required by public policy that the trustee should be answerable to the courts, so far at least as the honesty of his conduct is concerned." *Restatement (Second) of Trusts*, section 187 cmt. k.

If the terms of the trust include standards (e.g. health, education and support) the trustee must also act reasonably. If the terms of the trust do not contain standards, reasonableness is not required. *Restatement (Second) of Trusts,* section 187 cmt. i. However, use of extended discretion language also releases the trustee from the duty to act reasonably even if standards are used. *Restatement (Second) of Trusts*, section 187 cmt. j.

If a settlor purports to give a trustee extended discretion, the trustee may act "beyond the bounds of reasonable judgment, if he acts in good faith and does not act capriciously." And, if "by the terms of the trust [the trustee] is not required to act reasonably, the court will interfere where he acts dishonestly or in bad faith, or where he acts from an improper motive." II A. Scott & Fratcher, *The Law of Trusts*, section 187.2.

In effect, the traditional common law rule of extended discretion dispenses with the duty to act reasonably, but not with the duty to act honestly and in good faith.

3. No Expansion of Beneficiary Rights:

The *Restatement (Third)* does not depart from traditional rules of trustee discretion. Accordingly, the *Restatement (Third)* does not expand the rights of beneficiaries to seek review of trustee conduct.

C. Colorado Law:

Colorado case law is in accord with these *Restatement* principles. In the case of *In re Marriage of Jones,* 812 P.2d 1152 (Colo. 1991) the Supreme Court recognized that if the settlor gives the trustee uncontrolled discretion, the court will not interfere with its exercise unless the trustee "acts dishonestly or from an improper motive, or fails to use his judgement. *Jones*, supra, at p. 1156. As pointed out earlier in these materials, *Jones* did not involve actual review of discretion, rather the case involved the question whether a discretionary interest was "property" for purposes of division of property in a divorce proceeding.

In the case of *In re Estate of McCart*, 847 P.2d 184 (Colo. App. 1992), a panel at the Court of Appeals was asked to review a trustee's exercise of sole and absolute discretion. In upholding the beneficiary's claim for increased distributions, the court characterized the trustee's conduct as being an abuse of discretion, arbitrary, capricious, improperly motivated, and a "breach of his fiduciary responsibilities to act with upmost good faith and fairness toward the beneficiary." *McCart*, supra at p. 186.

D. ***Uniform Trust Code*, section 814(a):**

The *Uniform Trust Code* is in accord with this *Restatement* rule. *UTC*, section 814(a) provides:

Discretionary Powers; Tax Savings

> **(a) Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute", "sole", or "uncontrolled", the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.**
>
> *****

The comment to *UTC*, section 814(a) provides:

> "Subsection (a) requires a trustee exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to *Restatement (Second) of Trusts,* section 187 (1959), subsection (a) does not impose an obligation that a trustee's decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee's judgment can be tested. *Restatement (Second) of Trusts,* section 187 cmt. f [sic; should be i]." *Uniform Trust Code*, section 814(a) cmt.

E. Creditor's Rights – Expanded Beneficiary Rights Issue:

Some lawyers have expressed concern that the *Restatement (Third)* rules governing review of trustee discretion deviate from prior *Restatements* and common law principles in a way that expands the rights of beneficiaries to compel exercise of discretion and in so doing, increases the ability of a beneficiary's creditor who has attached the discretionary interest to compel exercise of discretion. See also discussion in section VIII, C 2 and 4, and IX C, supra.

For several reasons this is not the case. First of all, the *Restatement (Third)* does not deviate from traditional rules governing review of trustee discretion. Second, even though a trustee's exercise of discretion is always subject to judicial review to prevent abuse, even in the case of a creditor, the balancing process typical of discretionary issues becomes significantly weighed against the creditor. *Restatement*

(Third) of Trusts, section 60 cmt. e. Third, most trusts include spendthrift restraints which generally prevent attachment in the first place.

X. Creditors of Trustee:

A. **Rule of *Restatement (Third) of Trusts*, sections 5 and 42:**

2. *Restatement (Third) of Trusts*, section 42 provides:

Extent and Nature of Trustee's Title

Unless a different intention is manifested, or the settlor owned only a lesser interest, the trustee takes a nonbeneficial interest of unlimited duration in the trust property and not an interest limited to the duration of the trust.

2. *Restatement (Third) of Trusts*, section 5 provides in relevant part:

Trusts and other relationships.

The following are not trusts:

*****

(k) relationships of debtors and creditors.

*****

B. Discussion:

1. Bare Legal Title:

The interest taken by the trustee is nonbeneficial and reflects the fundamental concept that the beneficiary holds the beneficial interest (or "equitable title") in the trust property, while the trustee holds "bare" legal title to the property. *Restatement (Third) of Trusts*, section 42 cmt. a.

2. Fiduciary Relationship:

A property arrangement is a trust so long as it has the characteristics, and gives rise to the rights and duties, the law recognizes as a trust. Section 5

makes it clear that relationships of debtors to creditors is not a trust relationship and that a debtor owes no fiduciary duties to his or her creditor.

C. Effect:

Although a beneficial interest in a trust may generally be reached by creditors of the beneficiary (subject to the restraints on alienation discussed supra) the trustee's personal creditors or trustee in bankruptcy may not reach either the trust property or the trustee's nonbeneficial interest therein. Moreover, a trustee may not transfer the trust property or the nonbeneficial interest therein, except as may be incidental to the replacement or succession of trustees, or in exercising a power such as a power of sale. *Restatement (Third) of Trusts*, section 42 cmt. c.

When a trust is created there is a fiduciary relationship between the trustee and the beneficiaries. However, when the relationship is one of debt, the debtor does not stand in a fiduciary relationship to his or her creditor. A creditor merely has a personal claim against the debtor. *Restatement (Third) of Trusts*, section 5 cmt. k.

If a trustee becomes insolvent or bankrupt, the trustee's personal creditors may not reach the trust property and the beneficiary retains his or her equitable interest in that property. *Restatement (Third) of Trusts*, section 5 cmt. k.

This exemption of trust property from the personal obligations of the trustee is a significant feature of Anglo-American trust law. *Uniform Trust Code*, section 507 cmt.

1. Trustee/Beneficiary Distinction:

The rule of section 42 recognizes that a trustee takes only a nonbeneficial interest in the trust property. A trustee may, of course, also be a beneficiary of the trust but the resulting beneficial interest is not held in the trustee's fiduciary capacity. Bare legal title held by the trustee in a fiduciary capacity cannot be reached by the trustee's personal creditors. However, the beneficial interest may be reached by the trustee's personal creditors subject, of course, to restraints on alienation, if applicable. *Restatement (Third) of Trusts*, section 42 cmt. c.

2. Bankruptcy:

The foregoing rules are in accord with the Bankruptcy Act. 11 *U.S.C.*, section 541(d).

3. ***Uniform Trust Code*, section 507:**

The *UTC* rule is in accord:

> **Personal obligations of trustee.**
>
> **Trust property is not subject to the personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt.**

D. Colorado Law:

The *Restatement* rule is also in accord with Colorado law. *Lagae v. Lackner* was a case in which the transferee/trustee was described in the deed as simply "trustee." Under Colorado statutes in effect at the time, this was inadequate to give notice of the fiduciary nature of the title. However, the Colorado Supreme Court recognized that a valid trust had been created and held that the defect in title did not expose the trust property to the trustee's personal creditors. *Lagae v. Lackner*, 996 P2d. 1281 (Colo. 2000).

XI. Conclusion:

In Colorado we can be reasonably certain of the following rules as they pertain to creditors' rights in trusts: (i) the rule of spendthrift is valid; (ii) Colorado embraces the minority rule holding that property subject to a withdrawal power is insulated from the power holder's creditors until the power is exercised; (iii) property in a self-settled, spendthrift trust is not insulated from the claims of the settlor's creditors during the settlor's life; (iv) property in a trust is not subject to the personal creditors of the trustee; and (v) because of the recent enactment of section 15-15-103 *C.R.S.* (effective July 1, 2006) property in a revocable trust will clearly be subject to the claims of the deceased settlor's creditors. Apart from these rules, Colorado law does not address creditors' rights in trust property.

Thus, there is no Colorado law: (i) defining the rights of creditors to attach beneficial interests not protected by spendthrift; (ii) addressing remedies available to creditors who have successfully attached a beneficial interest; (iii) governing rights of creditors with respect to beneficiaries of revocable trusts other than settlor; (iv) identifying exceptions to the spendthrift rule; and (v) governing rights of creditors with respect to discretionary interests.

Because of the gaps in Colorado trust law, our courts have habitually turned to and followed the *Restatement* rule in deciding questions of trust law.

It is reasonable to assume that Colorado courts will continue to rely on the *Restatement* position until Colorado has a more developed body of trust law or adopts a comprehensive trust statute such as the *Uniform Trust Code*.

We must be familiar with the *Restatement* rules when advising settlors, beneficiaries, trustees and creditors.

Statutes

38-10-111

Statutes and Session Law

TITLE 38 PROPERTY - REAL AND PERSONAL

ARTICLE 10 Frauds - Statute of Frauds

38-10-111 Trusts for use of grantor void against creditors.

38-10-111. Trusts for use of grantor void against creditors.

All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person.

Source:L. 1861: p. 244, 11. **R.S.** p. 339, 11. **G.L.** 1261. **G.S.** 1520. **R.S. 08:** 2665. **L. 21:** p. 339, 1. **C.L.** 5110. **CSA:** C. 71, 11. **CRS 53:** 59-1-11. **C.R.S. 1963:** 59-1-11.

ANNOTATION

Law reviews. For article, "An Aspect of Estate Planning in Colorado: The Revocable Inter Vivos Trust", see 43 Den. L.J. 296 (1966). For article, "Perils of Pre-Bankruptcy Planning: Transfers, Exemptions and Taxes", see 17 Colo. Law. 1513 (1988). For article, "Chapter 13 Bankruptcy as an Alternative to Chapter 7", see 18 Colo. Law. 2089 (1989). For article, "Can Some Colorado Trusts Provide Protection from Claims of Creditors?", see 28 Colo. Law. 61 (August 1999).

Object of section is to invalidate transfers of property which have the effect of placing it beyond the reach of creditors of the person making the transfer, but which leave a beneficial use, control, or ownership in him. Wilson v. American Nat'l Bank, 7 Colo. App. 194, 42 P. 1037 (1895).

Applicability of section. This section refers to cases where the use of trust for the grantor is the principal purpose accomplished by the conveyance, and not merely an incident thereto. Campbell v. Colorado Coal & Iron Co., 9 Colo. 60, 10 P. 248 (1885).

A public welfare official is not precluded from using the state debtor and creditor law set forth in this section to set aside an allegedly fraudulent transfer so as to recover under social services law. Alberico v. Health Mgmt. Sys., Inc., 5 P.3d 967 (Colo. App. 2000).

"Things in action" include assignment of wages to be earned under a contract existing at the date of the assignment. City & County of Denver v. Jones, 85 Colo. 212, 274 P. 924 (1929).

There is no necessity of proving intent to defraud, but, if the assignment is shown to be in trust for the grantor, it is, as to existing creditors, the same as if no transfer had been made. Fulton Inv. Co. v. Smith, 27 Colo. App. 279, 149 P. 444 (1915), aff'd, 64 Colo. 33, 170 P. 1183 (1918).

Question of intention determined from facts of each case. The question of intention is one to be determined from the facts and circumstances of each case. Innis v. Carpenter, 4 Colo. App. 30, 34 P. 1011 (1893); Hunter v. Ferguson, 3 Colo. App. 287, 33 P. 82 (1893).

Express language of section invalidates conveyance to a trust as against the Colorado department of health care policy and financing ("DHF") because DHF was a creditor at the time of the transfer. Section does not provide additional or conflicting requirements for eligibility or

recovery under the medicaid act. Instead, section simply invalidates conveyance to trust made when creditors have outstanding claims at the time of the conveyance. Thus, defendants' liens are valid and enforceable against the mother's residence. Alberico v. Health Mgmt. Sys., Inc., 5 P.3d 967 (Colo. App. 2000).

Applied in Sickman v. Abernathy, 14 Colo. 174, 23 P. 447 (1890); Eppich v. Blanchard, 58 Colo. 139, 143 P. 1035 (1914); Zimmerman v. Mozer, 10 B.R. 1002 (D. Colo. 1981); In Re Baum, 22 F.3d 1014 (10th Cir. 1994).

15-15-103. Liability of nonprobate transferees for creditor claims and statutory allowances. (1) (a) EXCEPT AS OTHERWISE PROVIDED IN PARAGRAPH (b) OF THIS SUBSECTION (1), AS USED IN THIS SECTION, "NONPROBATE TRANSFER" MEANS A VALID TRANSFER EFFECTIVE AT DEATH BY A TRANSFEROR WHOSE LAST DOMICILE WAS IN THIS STATE TO THE EXTENT THAT THE TRANSFEROR IMMEDIATELY BEFORE DEATH HAD POWER, ACTING ALONE, TO PREVENT THE TRANSFER BY REVOCATION OR WITHDRAWAL AND INSTEAD TO USE THE PROPERTY FOR THE BENEFIT OF THE TRANSFEROR OR APPLY IT TO DISCHARGE CLAIMS AGAINST THE TRANSFEROR'S PROBATE ESTATE.

(b) THIS SECTION SHALL NOT APPLY TO:

(I) A SURVIVORSHIP INTEREST IN JOINT TENANCY REAL ESTATE; AND

(II) PROPERTY TRANSFERRED BY THE EXERCISE OR DEFAULT IN THE

EXERCISE OF A POWER OF APPOINTMENT, INCLUDING A POWER OF WITHDRAWAL, CREATED BY A PERSON OTHER THAN THE TRANSFEROR.

(III) PROCEEDS TRANSFERRED PURSUANT TO A BENEFICIARY DESIGNATION UNDER A LIFE INSURANCE, ACCIDENT INSURANCE, OR ANNUITY POLICY CONTRACT; AND

(IV) PROPERTY OR FUNDS HELD IN OR PAYABLE FROM A PENSION OR RETIREMENT PLAN, INDIVIDUAL RETIREMENT ACCOUNT, DEFERRED COMPENSATION PLAN, INTERNAL REVENUE CODE SECTION 529 PLAN, OR OTHER SIMILAR ARRANGEMENT.

(2) EXCEPT AS OTHERWISE PROVIDED BY PARAGRAPH (b) OF SUBSECTION (1) OF THIS SECTION, A TRANSFEREE OF A NONPROBATE TRANSFER IS SUBJECT TO LIABILITY TO ANY PROBATE ESTATE OF THE DECEDENT FOR ALLOWED CLAIMS AGAINST THE DECEDENT'S PROBATE ESTATE AND STATUTORY ALLOWANCES TO THE DECEDENT'S SPOUSE AND CHILDREN TO THE EXTENT THE ESTATE IS INSUFFICIENT TO SATISFY THOSE CLAIMS AND ALLOWANCES. THE LIABILITY OF A NONPROBATE TRANSFEREE MAY NOT EXCEED THE VALUE OF NONPROBATE TRANSFERS RECEIVED OR CONTROLLED BY THAT TRANSFEREE.

(3) NONPROBATE TRANSFEREES ARE LIABLE FOR THE INSUFFICIENCY DESCRIBED IN SUBSECTION (2) OF THIS SECTION IN THE FOLLOWING ORDER OF PRIORITY:

(a) A TRANSFEREE DESIGNATED IN THE DECEDENT'S WILL OR ANY OTHER GOVERNING INSTRUMENT, AS PROVIDED IN THE INSTRUMENT;

(b) THE TRUSTEE OF A TRUST SERVING AS THE PRINCIPAL NONPROBATE INSTRUMENT IN THE DECEDENT'S ESTATE PLAN AS SHOWN BY ITS DESIGNATION AS DEVISEE OF THE DECEDENT'S RESIDUARY ESTATE OR BY OTHER ACTS OR CIRCUMSTANCES, TO THE EXTENT OF THE VALUE OF THE NONPROBATE TRANSFER RECEIVED OR CONTROLLED;

(c) OTHER NONPROBATE TRANSFEREES, IN PROPORTION TO THE VALUES RECEIVED.

(4) UNLESS OTHERWISE PROVIDED BY THE TRUST INSTRUMENT, INTERESTS OF BENEFICIARIES IN ALL TRUSTS INCURRING LIABILITIES UNDER

THIS SECTION ABATE AS NECESSARY TO SATISFY THE LIABILITY, AS IF ALL OF THE TRUST INSTRUMENTS WERE A SINGLE WILL AND THE INTERESTS WERE DEVISEES UNDER THAT WILL.

(5) A PROVISION MADE IN ONE INSTRUMENT MAY DIRECT THE APPORTIONMENT OF THE LIABILITY AMONG THE NONPROBATE TRANSFEREES TAKING UNDER THAT OR ANY OTHER GOVERNING INSTRUMENT. IF A PROVISION IN ONE INSTRUMENT CONFLICTS WITH A PROVISION IN ANOTHER INSTRUMENT, THE PROVISION OF THE LATER INSTRUMENT SHALL PREVAIL.

(6) UPON DUE NOTICE TO A NONPROBATE TRANSFEREE, THE LIABILITY IMPOSED BY THIS SECTION IS ENFORCEABLE IN PROCEEDINGS IN THIS STATE, WHETHER OF NOT THE TRANSFEREE IS LOCATED IN THIS STATE.

(7) A PROCEEDING UNDER THIS SECTION MAY NOT BE COMMENCED UNLESS THE PERSONAL REPRESENTATIVE OF THE DECEDENT'S ESTATE HAS RECEIVED A WRITTEN DEMAND FOR THE PROCEEDING FROM THE DECEDENT'S SURVIVING SPOUSE OR A CHILD OF THE DECEDENT, TO THE EXTENT THAT STATUTORY ALLOWANCES ARE AFFECTED, OR A CREDITOR. IF THE PERSONAL REPRESENTATIVE DECLINES OR FAILS TO COMMENCE A PROCEEDING AFTER DEMAND, A PERSON MAKING DEMAND MAY COMMENCE THE PROCEEDING IN THE NAME OF THE DECEDENT'S ESTATE, AT THE EXPENSE OF THE PERSON MAKING THE DEMAND AND NOT OF THE ESTATE. A PERSONAL REPRESENTATIVE WHO DECLINES IN GOOD FAITH TO COMMENCE A REQUESTED PROCEEDING INCURS NO PERSONAL LIABILITY FOR DECLINING.

(8) A PROCEEDING UNDER THIS SECTION SHALL BE COMMENCED WITHIN ONE YEAR AFTER THE DECEDENT'S DEATH, BUT A PROCEEDING ON BEHALF OF A CREDITOR WHOSE CLAIM WAS ALLOWED AFTER PROCEEDINGS CHALLENGING DISALLOWANCE OF THE CLAIM MAY BE COMMENCED WITHIN SIXTY DAYS AFTER FINAL ALLOWANCE OF THE CLAIM.

(9) UNLESS A WRITTEN NOTICE ASSERTING THAT A DECEDENT'S PROBATE ESTATE IS NONEXISTENT OR INSUFFICIENT TO PAY ALLOWED CLAIMS AND STATUTORY ALLOWANCES HAS BEEN RECEIVED FROM THE DECEDENT'S PERSONAL REPRESENTATIVE, THE FOLLOWING RULES APPLY:

(a) PAYMENT OR DELIVERY OF ASSETS BY A FINANCIAL INSTITUTION, REGISTRAR, OR OTHER OBLIGOR TO A NONPROBATE TRANSFEREE IN ACCORDANCE WITH THE TERMS OF THE GOVERNING INSTRUMENT

CONTROLLING THE TRANSFER RELEASES THE OBLIGOR FROM ALL CLAIMS FOR AMOUNTS PAID OR ASSETS DELIVERED.

(b) A TRUSTEE RECEIVING OR CONTROLLING A NONPROBATE TRANSFER IS RELEASED FROM LIABILITY UNDER THIS SECTION WITH RESPECT TO ANY ASSETS DISTRIBUTED TO THE TRUST'S BENEFICIARIES. EACH BENEFICIARY, TO THE EXTENT OF THE DISTRIBUTION RECEIVED, BECOMES LIABLE FOR THE AMOUNT OF THE TRUSTEE'S LIABILITY ATTRIBUTABLE TO ASSETS RECEIVED BY THE BENEFICIARY.

(10) THE RECEIPT OF FUNDS DERIVED FROM NONPROBATE TRANSFEREES BY A PERSON AS PROVIDED IN THIS SECTION IN SATISFACTION OF SUCH PERSON'S CLAIM FOR A DEBT OR STATUTORY ALLOWANCES DOES NOT CONSTITUTE THE RECEIPT OF NONPROBATE PROPERTY BY SUCH PERSON FOR PURPOSES OF THIS SECTION OR PART 2 OF ARTICLE 11 OF THIS TITLE.

(11) IN THE EVENT OF ANY CONFLICT IN THE PROVISIONS OF THIS SECTION WITH THE PROVISIONS OF PARTS 2 AND 4 OF ARTICLE 11 OF THIS TITLE, THE PROVISIONS OF THIS SECTION SHALL CONTROL.

Cases

In re Baum, 22 F.3d 1014 (10th Cir. 04/26/1994)

[1] UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

[2] No. 92-1365

[3] 1994.C10.40982 <http://www.versuslaw.com>; 22 F.3d 1014

[4] Filed: April 26, 1994.

[5] **IN RE: JEROME S. BAUM, DEBTOR. TOM H. CONNOLLY, TRUSTEE, PLAINTIFF-APPELLANT,**
v.
JEROME S. BAUM, GARRETT ADAM BAUM, COURTNEY JILL BAUM, TOM W. LAMM, DEFENDANTS-APPELLEES.

[6] Appeal from the United States District Court for the District of Colorado. D.C. No. 91-C-1215. D.C. Judge JIM R. CARRIGAN

[7] Curt P. Kriksciun of The Connell Law Firm, Denver, Colorado, for Plaintiff-Appellant.

[8] Harry M. Sterling (David M. Tenner, also of Gelt, Fleishman & Sterling, with him on the brief), Denver, Colorado, for Defendants-Appellees.

[9] Before Logan and Brorby, Circuit Judges, and Seay, Chief District Judge.*fn*

[10] Logan

[11] LOGAN, Circuit Judge.

[12] Plaintiff Tom H. Connolly, Trustee in Bankruptcy, appeals the district court's grant of summary judgment denying him relief and upholding the validity of two trusts the assets of which plaintiff sued to include in Jerome S. Baum's bankruptcy estate. On appeal, plaintiff argues that the trusts are void as shams or because of merger of legal and equitable interests.

[13] I

[14] In October 1983, Baum (debtor or settlor) established and filed of record a trust instrument entitled the Baum Children Trusts, creating two irrevocable trusts denoted as the Garrett Adam Baum Trust and the Courtney Jill Baum Trust and naming Tom W. Lamm as trustee. Garrett Adam Baum and Courtney Jill Baum are debtor's children. Debtor transferred into the trusts his residence, some furniture and fixtures, and a collection of antique clocks. Debtor reserved the right to live in the residence under the following terms:

[15] For so long as the Settlor shall be living, he shall [have] the right to occupy [the] residence free of rental so long as the Settlor timely services all encumbrances against such residence, and pays all taxes, insurance and utilities on such residence or associated with its occupancy by the Settlor. Further, in the event of the death of the Settlor, and if Rachael Elizabeth shall then be the spouse of the Settlor as contemplated in paragraph 10.4 below, and if the said Rachael Elizabeth Baum survives the Settlor, then, until the earlier to occur of the death of Rachael Elizabeth Baum or the second anniversary of the date of her remarriage, the said Rachael Elizabeth Baum shall have the right to occupy such property as her principal residence free of rental so long as she shall timely service all encumbrances against such residence, and pays all taxes, insurance and utilities on such residence or associated with her occupancy.

[16] Appellant's App. 98-99. Debtor also reserved to himself and his wife the right to require the trustee to sell the residence and purchase another home as substitute trust property

[17] so long as the expenditures required by the trusts herein created in order to secure a new residence together with any contributions by the occupant, shall not be in excess of the net proceeds of sale of the old residence, and so long as the trusts herein created are exposed to no greater liabilities or risks of loss than those to which the trusts are exposed prior to the sale of the old residence.

[18] Id. at 99.

[19] When debtor created the trusts he and his wife were experiencing marital difficulties and wanted to preserve certain separate property for their children from their prior marriages. The trusts authorized the trustee to distribute income or principal based on the "best interests" of the children beneficiaries as determined by the trustee. Id. at 96, 97, 101-02. The trusts contemplated distributions for the "support," "comfort and convenience" of those beneficiaries. Id. at 102. At the time the trusts were created, debtor had a net worth of over $1,000,000; he had total debts of less than $115,000, consisting of about $19,000 owed to his ex-wife and $90,000 to $95,000 on a mortgage on the residence. Appellant's App. 83-84.

[20] About six years later, in 1989, debtor filed for Chapter 7 bankruptcy. Plaintiff was appointed trustee and filed this action to recover the trust property for the bankruptcy estate,

asserting: (1) the creation of the trusts constituted transfers in trust for the benefit of the debtor and thus were void under Colorado law; and (2) debtor used trust property as his own, effecting a merger of legal and equitable interest in the property of the trusts.*fn1 The bankruptcy court referred the case to the district court, whose grant of summary judgment upholding the validity of the trusts was appealed to this court.

[21] We review a district court's order granting summary judgment de novo, applying the same legal standard used by the district court under Fed. R. Civ. P. 56(c). Anaconda Minerals Co. v. Stoller Chem. Co., 990 F.2d 1175, 1177 & n.3 (10th Cir. 1993). We view the record "in a light most favorable to the parties opposing the motion for summary judgment." Deepwater Invs., Ltd. v. Jackson Hole Ski Corp., 938 F.2d 1105, 1110 (10th Cir. 1991). "Summary judgment is appropriate when there is no genuine dispute over a material fact and the moving party is entitled to judgment as a matter of law." Russillo v. Scarborough, 935 F.2d 1167, 1170 (10th Cir. 1991). Once the moving party meets its burden, the burden shifts to the nonmoving party to demonstrate a genuine issue for trial on a material matter. Bacchus Indus., Inc. v. Arvin Indus., Inc., 939 F.2d 887, 891 (10th Cir. 1991). "The nonmoving party may not rest on its pleadings but must set forth specific facts showing that there is a genuine issue for trial as to those dispositive matters for which it carries the burden of proof." Applied Genetics Int'l, Inc. v. First Affiliated Sec., Inc., 912 F.2d 1238, 1241 (10th Cir. 1990) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 324, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)).

[22] The bankruptcy estate includes, "except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. 541(a)(1). For purposes of 541, the nature of a debtor's interest in property generally is determined by state law. Butner v. United States, 440 U.S. 48, 54-55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979). Thus, if the trusts are shams or otherwise void under Colorado law the trust property is includable in the bankruptcy estate.

[23] II

[24] Plaintiff's arguments fall into two categories: The trusts were void at their inception, or at least voidable if necessary for the benefit of creditors, regardless of how they may have been operated; or, alternatively, the trusts are shams because of the way they were operated.*fn2 We consider the void or voidable argument first.

[25] A Colorado statute voids "all deeds of gifts, all conveyances . . . of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person." Colo. Rev. Stat. 38-10-111. Plaintiff was not an existing creditor at the time the trusts were created in 1983. He became entitled to stand in the shoes of all creditors existing at the time bankruptcy was filed in 1989; but there is no showing that debtor's ex-wife was a creditor in 1989, or that the mortgage holder in 1983 is claiming to share the bankruptcy estate.

[26] Colorado courts would also hold void in a suit on behalf of creditors a trust in which the settlor is the sole beneficiary or has the sole power to reach the trust property. Kaladic v. Kaladic, 41 Colo. App. 419, 589 P.2d 502, 505 (Colo. App. 1978) (holding illusory and fraudulent a spendthrift trust that ex-wife attempted to create with marital assets shortly before divorce, naming herself as sole beneficiary). The trusts at issue before us are irrevocable. By their terms settlor is not the sole beneficiary, and he does not have the power to revest the trust property in himself.

[27] Debtor is a beneficiary in that he has the right to occupy the residence during his life and use the furnishings, subject to a duty to keep up payments on any mortgage and to pay all taxes, insurance and utilities. The trust does not have spendthrift provisions--which would be ineffective in any event--to prevent current creditors from reaching settlor's interest. See id. Therefore, regardless of the success of plaintiff's other arguments, the value of debtor's life estate can be reached for the benefit of his creditors unless it is protected by Colorado's homestead exemption. See Colo. Rev. Stat. 38-41-201 (limiting homestead exemption to $30,000). However, debtor presented factual support for his assertion that his own beneficial interest in the trusts was minimal; he paid $1652 per month for debt service, taxes and insurance, Appellant's App. 83, 98, while the rental value of the property was between $1250 and $1500 per month. Id. at 93.

[28] Arguably debtor's right to occupy the residence gives him the right to use and enjoy the furnishings and clocks transferred to the trusts. There are cases holding that a life estate in consumable personal property is the equivalent to full fee simple title. See, e.g., Seabrook v. Grimes, 107 Md. 410, 68 A. 883 (1908). It is unlikely, however, that the furnishings and clocks transferred to the trust would be regarded as consumable. In any event debtor presented evidence that all but four of the clocks had been sold and the proceeds turned over to the children beneficiaries to pay their educational expenses and that all furniture except one desk and mirror had been given to the children some years ago.

[29] Colorado law provides the following elements are required to establish an express private trust: "(1) the settlor's capacity to create a trust; (2) his intention to create a trust; (3) a declaration of trust or a present Disposition of the res; (4) an identifiable trust res; (5) a trustee; and (6) identifiable beneficiaries." In re Estate of Granberry, 30 Colo. App. 590, 498 P.2d 960, 963 (Colo. App. 1972) (citing Restatement (Second) of Trusts 17, et seq.; G. Bogert, Trusts and Trustees 41, et seq. (2d ed.)); see also Estate of Brenner, 37 Colo. App. 271, 547 P.2d 938, 941 (Colo. App. 1976). Settlor possessed the capacity in 1983 to create the trusts; he stated his intention in writing; his declaration was in a formal document duly executed and recorded; he transferred assets to establish an identifiable res; he named a trustee and identifiable beneficiaries. Thus, the trusts in the instant case are valid on their face. The trusts were executed for a purpose other than avoidance of creditors, to provide for children of a prior marriage in the context of settlor's marital problems. Unless the trusts are shams on the basis of their operation we must affirm the district court's judgment that the trusts are valid.

[30] III

[31] Plaintiff asserts that in practice certain of the essential elements to establish valid trusts--intent, identifiable trust res, and a trustee--were rendered ineffective by the action of debtor and the trustee, and thus the trusts are shams. The burden of proof rests on the plaintiff, of course, to show that what appear on their face to be valid trusts are indeed shams.

[32] We have not discovered, and the parties have not directed our attention to, any Colorado trust cases dealing specifically with creation of a sham trust by a debtor. We acknowledge, however, that there is persuasive authority in other contexts, particularly corporate and tax cases, that when a person in a position analogous to debtor here retains too much control over transferred property, ignores legal formalities, and uses the property as his own, the property is treated as owned by the transferor rather than the entity that is the nominal owner. We have reviewed the cases relied on by plaintiff, but they are all distinguishable from the instant case.

[33] In support of his sham trust argument, plaintiff alleges that debtor retained extensive control over the trust properties, citing debtor's retained authority to veto the sale of the home and to request replacement of that home with one of his choosing. But we note the trust instrument limits the amount spent to procure such a residence to the net proceeds of the sale plus additional contributions made by settlor, and limits the liabilities and risks of loss to that existing before the sale. Debtor's summary judgment motion was supported by evidence which if true, establishes that the trusts were settled and indeed operated for the benefit of his children. He provided deposition testimony that the clocks were sold to provide cash for the named beneficiaries' needs, and that nearly all of the furniture was distributed to the beneficiaries to furnish their apartments. He presented evidence that he paid out monthly more for debt service, taxes, and insurance than the fair rental value of the residence.

[34] Plaintiff asserts that the trustee failed to administer the trusts. In support, he cites the trustee's deposition testimony that he had no inventory of the furniture and fixtures nor of their value, that he had no specific recollection as to the sale of any of the trust property, that he had no records concerning transactions involving trust property, and had "done almost nothing" in his role as trustee. Appellant's App. 217. Plaintiff thus presented evidence that the named trustee failed to properly administer the trusts, and that settlor carried out most of the trustee's duties. The trustee did sign and file tax returns and signed all papers respecting transfers of additional assets held in the trust and for a second mortgage placed on the residence.*fn3

[35] However, even if debtor acted as trustee, it does not follow that the trust is a sham. Cf. Estate of Brenner, 37 Colo. App. 271, 547 P.2d 938 (Colo. App. 1976) (for estate purposes trust valid though settlor was sole trustee, sole income beneficiary for his lifetime, with reserved power to amend and revoke the trust). Plaintiff produced no evidence to rebut the deposition testimony of debtor and the trustee that the trust property with respect to which settlor acted was used solely for the benefit of the children beneficiaries. Plaintiff produced no factual evidence of self-dealing by debtor. The most questionable transaction was the second mortgage placed on the residence, later paid off, and the lack of records as to where the proceeds of the loan were held pending their payout for educational expenses of the

children. But even considering the post-summary judgment deposition testimony of debtor's wife, plaintiff cannot show that the proceeds were used other than for the sole benefit of the children beneficiaries. We hold that plaintiff has failed to meet his burden of creating a material issue of fact concerning the allegation that the trusts were shams operated for debtor's benefit. See Applied Genetics, 912 F.2d at 1241 (party opposing summary judgment must set forth specific facts showing a genuine issue for trial).

[36] Plaintiff also argues that the trusts failed by reason of merger of legal and equitable interests. The essence of a valid trust is separation of the legal and equitable interests in property, with legal title held by the trustee, and the beneficial interest vested in the beneficiaries. If at any point all of the legal and equitable interests are held by one person or entity, the interests merge and the trust fails. See, e.g., In re Klayer, 20 Bankr. 270 (Bankr. W.D. Ky. 1981) (merger of legal and equitable where a settlor was trustee and sole beneficiary). Courts have found merger where the settlor as trustee engaged in self-dealing and used trust property to secure his own debts, see In re Flanzbaum, 8 Bankr. 971 (Bankr. S.D. Fla. 1981). However, as long as the interests are in some way different, in the absence of self-dealing there is no merger. See id.; Estate of Brenner, 547 P.2d at 942 (where settlor named himself as trustee, with income for life and right to withdraw any or all property, or revoke trust, no merger because there were residual beneficiaries who had vested interests) (citing Denver Nat'l Bank v. Von Brecht, 137 Colo. 88, 322 P.2d 667 (Colo. 1958)).

[37] Even though debtor performed many of the duties of the trustee, there were other beneficiaries, there were limitations on debtor's life estate in the residence, and there was no evidence of self-dealing. Plaintiff has failed to raise a genuine issue as to whether the legal and equitable interests in the trusts merged.

[38] We therefore AFFIRM the judgment of the district court. We deny debtor's motion to strike plaintiff's reply brief.

Judges Footnotes

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[39] *fn* The Honorable Frank H. Seay, Chief Judge, United States District Court for the Eastern District of Oklahoma, sitting by designation.

Opinion Footnotes

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[40] *fn1 Plaintiff also contended the transfer was a fraudulent conveyance, but has not appealed the summary judgment on the fraudulent conveyance claim.

[41] *fn2 Debtor asserts that plaintiff did not raise the issue of sham trusts below, except as to the Colorado statute on self-settled trusts. We have reviewed the pleadings and hold that plaintiff did raise the broader issue in his first and third claims for relief.

[42] *fn3 Apparently debtor transferred some limited partnership interests to the trusts which later proved worthless. The trustee acted for the trust in one major lawsuit. Appellant's App. 242-45.

19940426

Brasser v. Hutchison, 549 P.2d 801, 37 Colo. App. 528 (Colo.App. 04/22/1976)

[1] Colorado Court of Appeals

[2] No. 75-721

[3] 549 P.2d 801, 37 Colo. App. 528, 1976.CO.40341 <http://www.versuslaw.com>

[4] Decided: April 22, 1976.

[5] **ROGER A. BRASSER**
v.
JOE C. HUTCHISON, FREIDA M. HUTCHISON, MERCEDES C. HUTCHISON AND ZACK HAGER AND THE FIRST NATIONAL BANK OF COLORADO SPRINGS

[6] Appeal from the District Court of the City and County of Denver, Honorable John Brooks, Jr., Judge.

[7] Richard N. Graham, for plaintiff-appellant.

[8] Murray, Baker & Wendelken, William A. Baker, for garnishee-appellee.

[9] Opinion by Judge Van Cise. Judge Coyte and Judge Kelly concur.

[10] Van Cise

[37 ColoApp Page 529]

[11] Plaintiff, Roger A. Brasser, appeals from a judgment dismissing his traverse of answers to a writ of garnishment. We affirm.

[12] Brasser obtained a judgment against the defendants and thereafter caused a writ of garnishment to be issued and served on the First National Bank of Colorado Springs (the bank) as garnishee. The bank was trustee of a trust under the will of George Hutchison, deceased, for the benefit of decedent's widow, Mercedes Hutchison, one of the individual defendants.

[13] In its answers to the interrogatories accompanying the writ of garnishment, the bank acknowledged that some $2,700 of accrued but unpaid income from the trust was on hand at the time of service and that additional amounts were received thereafter and not distributed pending court order. It asserted that the widow's interest in the trust, as to both income and corpus, was not subject to garnishment on a judgment because it was protected by the "spendthrift" provisions contained in decedent's will. Those provisions are:

[14] "No beneficiary of any trust created herein shall, during the continuance of the trust, acquire any right in or title to any corpus or income, otherwise than by and through the actual payment of such income or corpus by the Trustee to the beneficiary . . . nor shall any beneficiary have the right or power by drafts, assignment, or otherwise, to transfer, assign, anticipate or mortgage, or otherwise to encumber in advance any corpus or income, or to give orders in advance upon the Trustee for any corpus or income; nor shall any such interest of any beneficiary be subject to seizure or sequestration for the payment of any debts, torts, alimony, separate maintenance or other liabilities of any such beneficiary. . . ."

[15] Brasser traversed the answer, but his traverse was denied and, after hearing, the garnishee bank was discharged. Brasser appeals.

[16] The parties do not dispute that spendthrift provisions are legal and enforceable in Colorado. Snyder v. O'Conner, 102 Colo. 567, 81 P.2d 773. Nor does Brasser deny that the language of the provision quoted above is clear and explicit enough to show the testator's intention to create a "spendthrift trust." See Newell v. Tubbs, 103 Colo. 224, 84 P.2d 820. Rather, he contends that the provisions of the will setting up the trust for the widow and then imposing spendthrift restrictions on the income interest are inconsistent.

[17] He points out that the will expressly requires the trustee to "pay over the entire net income" to the widow "in convenient installments, at least quarterly, during her lifetime." Brasser maintains that his provision vests equitable title to the income in the widow, creating an inconsistency with the language of the spendthrift provisions denying her any right or title to the income prior to actual payment.

[18] He notes further that the testator's intent to qualify the trust for the federal marital deduction is manifested in the will both expressly and

[37 ColoApp Page 530]

implicitly by the nature of the terms of the trust. Since a condition for such qualification is that the spouse have an absolute right to all income from the trust, see Starrett v. Commissioner of Internal Revenue, 223 F.2d 163 (1st Cir.), he argues that decedent's intent in this regard must take precedence over the inconsistent language of the spendthrift provisions.

[19] In response to this latter contention, we would point out that the precise dispositive issue before us is not the qualification of the trust for the estate tax marital deduction, but whether the spendthrift provisions in this will should be enforced against a garnisheeing creditor of the beneficiary. And, to arrive at that determination, we need not address the estate tax implications of the will, but rather need only to ascertain (1) the intent of the testator in light of the apparently inconsistent provisions of the will, and (2) the effect of C.R.C.P. 103 upon the trust's spendthrift provisions.

[20] I.

[21] "The cardinal rule in the construction of a Will is that the Court shall determine the actual intent of the testator from the instrument in its entirety and, having ascertained that intent, shall carry it out, provided that the testator's intent conforms to law and public policy." Meier v. Denver U.S. National Bank, 164 Colo. 25, 431 P.2d 1019.

[22] Viewing the will as a whole, we find it clear that the testator's intention was to provide a fund for the maintenance of his widow for her life by means of a trust which would qualify for the maximum federal estate tax deduction, and at the same time to secure this fund against her improvidence or incapacity, see Newell v. Tubbs, supra, by assuring that the income was paid directly to her and to no one else. We see nothing in this which is either internally inconsistent or contrary to our law or public policy. See Restatement (Second) of Trusts § 152, Comment h; 2 A. Scott, Trusts § 152.5.

[23] In giving effect the obvious intent of the testator, words may be transposed, supplied or rejected. In re Estate of Boyle, 121 Colo. 599, 221 P.2d 357; In re Estate of Rochester, 126 Colo. 54, 246 P.2d 906. Hence, if a literal interpretation of the portion of the spendthrift provisions dealing with right to income before actual payment would create an inconsistency with the plain intent of the testator as unmistakably revealed in the rest of the will, then those words should be disregarded. This is particularly appropriate where, as here, the troublesome language adds nothing to the protection of the widow's interest that is not already provided for in the balance of the same sentence.

[24] II.

[25] C.R.C.P. 103(b) permits the garnishment of a defendant's property in the hands of a third party "whether they are due at the time of the service of the writ or are to become due thereafter," See Stone v. Chapels for Meditation, Inc., 33 Colo. App. 346, 519 P.2d 1233, and subsection (z) of the Rule makes garnishment remedies available to judgment creditors in aid of execution. However, C.R.C.P. 103 is not applicable here. Spendthrift provisions being recognized in this state, Snyder v.

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O'Conner, supra, funds under the control of a trustee subject to such provisions cannot be garnisheed.

[26] Judgment affirmed.

[27] Disposition

[28] Affirmed.

19760422

8 P.3d 429; IN RE: COHEN;

In the Matter of Gary Steven COHEN, Attorney-Respondent.

No. 97SA211.

Supreme Court of Colorado, En Banc.

September 13, 1999.

[Copyrighted West material redacted at this point. This is the end of official text of this page. Page numbering jumps forward to where the official text resumes.]

John S. Gleason, Attorney Regulation Counsel, James C. Coyle, Assistant Regulation Counsel, Denver, Colorado, Attorneys for Complainant.

Jean E. Dubofsky, Boulder, Colorado, Jay P.K. Kenney, Denver, Colorado, Attorneys for Attorney-Respondent.

PER CURIAM.

The respondent in this lawyer discipline case, Gary Steven Cohen, was charged with representing conflicting interests. A hearing panel of the supreme court grievance committee approved the findings and conclusions of a hearing board, but modified the board's recommendation of a thirty-day suspension to ninety days. Cohen excepted to the recommendation of discipline. We accept the hearing panel's recommendation and order that the respondent be suspended for ninety days from the practice of law.

I.

Gary Steven Cohen has been licensed to practice law in Colorado since 1976. The facts underlying the complaint were hotly

contested and the evidence presented to the hearing board was in stark conflict. Following the hearing, the board made the following factual findings by clear and convincing evidence.

Cohen represented Thomas Mars and his businesses, Mars Steel & Iron and Mars Steel Corporation, in a number of legal matters from 1986 through 1990. Mars's son, Zane, was seriously injured in a motorcycle accident on July 4, 1985, when he collided with another vehicle. He sustained a closed-head injury and other injuries. Zane was twenty-one years old at the time of the accident. He was subsequently charged with a criminal offense. A lawyer other than Cohen initially represented Zane on the criminal charges and in a civil action brought against the driver of the other vehicle. In 1987, Cohen took over representing Zane in both cases. In the criminal case, Cohen filed a successful motion to suppress, resulting in the dismissal of the charges. He also obtained a substantial verdict on Zane's behalf in the civil case which was eventually settled on March 30, 1989 for $750,000.

At the time of the settlement, Zane was twenty-six years old, had graduated from high school, had

quite limited business and financial experience, and was suffering from the effects of a closed head injury. Zane and his parents had discussions with Cohen prior to the settlement concerning the wisest way to resolve the matter and provide Zane with some protection and future security. Eventually it was decided to place the settlement proceeds in trust with Cohen as the trustee.

It is at this point that the parties started to disagree strongly. The complainant asserted that at about the time the settlement was entered into, the parties agreed orally to create an irrevocable spendthrift trust,(fn1) with Zane being the beneficiary and Cohen the trustee.

Cohen on the other hand alleges that no trust at all was created until the written trust agreement was entered into on August 28, 1989, because until that time Zane was ambivalent about whether he wanted a trust and the specific terms of the trust were not established until it was reduced to writing. According to Cohen, from the end of March to August, only a resulting trust existed, and Cohen's role was limited to being an agent responsible to the wishes of his principal, Zane.

The hearing board determined that the overwhelming weight of the evidence supported the complainant's position. "There is no question but that an oral irrevocable spendthrift trust was established on or about March 30, 1989, with Zane A. Mars as the beneficiary and Cohen as the trustee. First, Zane testified that it was his intent to create the trust when the case was settled. Second, the written agreement states that it "is made and entered into as of March 30, 1989." Third, while the first promissory note drawn by Cohen and executed by Zane's father on April 4, 1989 was originally made payable to Zane Mars, almost immediately the note was cancelled and rewritten in the name of "The Zane A. Mars Trust [hereafter "the Trust"] (Payee), Gary A. Cohen, Trustee."

In addition, subsequent promissory notes and a deed of trust referred to the Trust as the payee; Cohen's billing records beginning on March 31, 1989 charges his services to the "Z. Mars Trust"; the Trust Registration Statement refers to the trust as having been established on March 30, 1989; and Cohen obtained a tax identification number from the IRS for the trust. All of this occurred before the written trust agreement was executed on August 28, 1989. In his opening brief in this court, Cohen did not contest the board's finding that an oral spendthrift trust became effective on March 30, 1989.(fn2)

Before Zane's settlement was reached, there were discussions between Zane and his father concerning Mars Steel Corporation borrowing some of the settlement proceeds on a short term basis. After Zane's case was settled and the oral spendthrift trust was created, Thomas Mars persuaded his son to approve or authorize a short term loan of $50,000 to the corporation. Thomas Mars believed at the time that he would be granted a Small Business Administration loan within a short period of time. The board found that Zane felt obligated to make the loan to his father because he had supported Zane during his convalescence and the ensuing litigation. Zane and his father asked Cohen to draft a promissory note and to release the funds to the father. The maker of the note was Mars Steel Corporation. The note was unsecured, although Thomas Mars signed a personal guarantee. This was the April 4, 1989 note that was redrafted to make the Trust the payee. When Cohen prepared the note, he was still representing Thomas Mars in his business matters. He was at the same time Zane's lawyer and the trustee of the Trust.

When the April 4, 1989 note came due, Thomas Mars's application for the SBA loan had still not been approved. In fact, it was never approved because of the corporation's poor financial circumstances. Neither the corporation nor Thomas Mars paid the note when it was due. Nevertheless, even though the first loan was in default, Cohen advanced another $44,000 of the Trust's funds to the Mars Steel Corporation. He did this at the direction of Zane and his father. Cohen also prepared a factoring

agreement on Mars Steel Corporation's receivables as security for the second loan. Zane testified at the hearing that he was reluctant to approve the loan and he hoped that Cohen would deny it for him. Cohen's conflict of interest was further compounded by the fact that Thomas Mars now owed him substantial attorney fees. Before drafting the documents for the first and second loans, Cohen advised both the father and son that they should have independent counsel because of his attorney-client relationship with each of them. Neither Zane nor his father obtained an independent lawyer, and Cohen drafted the notes and released the funds to Mars Steel Corporation and Thomas Mars.

About June 15, 1989, Zane told Cohen that his father was pressing him to make yet another loan from the Trust, this time for $100,000. The purpose of the loan was to pay off an IRS lien. The board found this to be a clear sign that the corporation was in severe financial trouble. Cohen told Zane to consult with another lawyer. At Zane's urging, Cohen arranged to get Zane a lawyer, who Zane said would be paid by his father. There was a lunch meeting among Zane, his father, Cohen, and the second lawyer. This lawyer did not review the documents or the details of the transaction, and Cohen knew this. Neither Cohen nor Thomas Mars provided the second lawyer with sufficient information about the financial condition of either the corporation or Thomas Mars for the lawyer to give Zane appropriate legal advice. The board concluded that Zane did not receive truly independent legal advice, and that Cohen either knew or should have known this. Nevertheless, Cohen drafted the necessary documents which involved obtaining a loan through the bank handling the Trust. As security for the bank loan, Cohen, as trustee for the Trust, executed an assignment of a $100,000 certificate of deposit owned by the Trust.

At the hearing, Cohen took the position that by drafting the promissory notes and other documents evidencing the transactions between Thomas Mars and Zane Mars and the Trust, he was simply acting as a scrivener, not a lawyer. The board found otherwise by clear and convincing evidence. First, Zane considered Cohen to be his lawyer from the outset. And the instruments themselves go well beyond the terms actually conveyed to Cohen by the parties to the transactions, "and clearly reflect [a] lawyer's input in the provisions."

Neither the corporation nor Zane's father repaid any of the notes. Eventually the corporation and Thomas Mars filed for bankruptcy. Cohen took no action whatsoever to collect on any of the notes or to foreclose on the collateral, such as it was. In 1994, however,

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Zane and the successor trustee of the Trust settled a malpractice action they brought against Cohen and the lawyer that was supposed to provide Zane with independent legal advice. The board concluded that Zane and the Trust were thereby "made whole."

The hearing board further determined that by simultaneously representing Thomas Mars and Mars Steel Corporation, as well as Zane and the Trust, Cohen violated DR 5--101(A) (accepting employment if the exercise of the lawyer's professional judgment will or reasonably may be affected by the lawyer's own financial, business, property, or personal interests); and DR 5--105(B) (continuing multiple employment even though the exercise of the lawyer's independent professional judgment will be, or is likely to be, affected by the representation of another client, or if the multiple employment is likely to involve the lawyer in representing differing interests). He also violated DR 1--102(A)(6) (engaging in conduct adversely reflecting on the lawyer's fitness to practice) and C.R.C.P. 241.6(2) (violating accepted rules or standards of legal ethics). The board found, however, that the complainant had not proven by clear and convincing evidence that Cohen had violated DR 6--101(A)(3) (neglecting a legal matter entrusted to the lawyer). According to the board, "It is not clear that at the time the defaults

occurred any action to recover on the loans would have been successful."

II.

The hearing panel generally approved the findings and conclusions of the hearing board, but modified the board's recommendation of a thirty-day suspension to a suspension for ninety days. Cohen filed exceptions to the panel's and board's recommendations.

As we mentioned above, the parties agreed that a valid spendthrift trust was created at some point; they differed only on when it came into being. After the case was at issue in this court, we ordered the parties to submit written briefs on the following issues:

Whether the Zane A. Mars Trust violates section 38--10--111 and/or public policy.

If the trust violates the statute and/or public policy, what is the effect on the existence of the trust.

If the Trust is invalid, what effect does this have on the Findings and Recommendation of the Hearing Board that found the Trust to be a valid oral spendthrift trust beginning March 1989.

The key issue litigated below was whether an oral spendthrift trust(fn3) was created in March 1989 or the trust came into being when it was put in writing in August 1989. Cohen and his expert witnesses testified that the trust only came into existence in August, whereas the complainant asserted that it began in March. The gravamen of the complaint was that Cohen as trustee breached the prudent investor rule by permitting the trust to lend a total of $200,000 between March and August to Zane's father's business, which was not repaid because the business failed. Cohen's position was that, until August 1989, he acted as the agent of his principal, Zane, in permitting Zane to loan his father the funds. Therefore, when he made the loans at issue (all before August 1989) he was merely acting as an agent obeying the orders of Zane, his principal. According to the argument Cohen presented to the hearing board, his actions were not unethical because they did not breach any duties relevant to a straight principal-agent relationship. The hearing board, however, found that an oral trust came into being in March so that Cohen should not have allowed the loans.

Apparently, the parties had no interest in questioning the validity of the *written* spendthrift trust. However, Restatement (Second) of Trusts § 156 (1959) states:

§ 156. Where the Settlor is a Beneficiary.

(1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.

(2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee could pay to him or apply for his benefit.

As one commentator has stated:

Even in jurisdictions in which spendthrift trusts are permitted, the settlor cannot create a

> spendthrift trust for his own benefit. If the owner of property transfers it in trust to pay the income to himself for life or for a period of years, and provides that his interest under the trust shall not be assignable by him and that his creditors shall not be permitted to reach it, *nevertheless he can effectively assign his interest and his creditors can reach it.* It is immaterial that in creating the trust the settlor did not intend to defraud his creditors . . . . It is against public policy to permit a man to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it.

William F. Fratcher, IIA *Scott on Trusts* § 156, at 164--67 (4th ed.1987) (emphasis added); *see also Hanson v. Minette,* 461 N.W.2d 592, 595 (Iowa 1990) ("While the trust contains spendthrift-type language, it is universally held that a settlor may not create a spendthrift trust in favor of himself."); *In re Johannes Trust,* 191 Mich.App. 514, 479 N.W.2d 25, 29 (1991) (concluding that the creditors could reach the assets of a "spendthrift" trust to the same extent as the maximum amount that would be payable to the beneficiary in the trustee's discretion); *Miller v. Ohio Dep't of Human Servs.,* 105 Ohio App.3d 539, 664 N.E.2d 619, 621 (1995) (self-settled spendthrift trusts are void as against public policy); *Farmers State Bank v. Janish,* 410 N.W.2d 188, 190 (S.D.1987) (spendthrift trust created by beneficiary and other parties out of sums they received in settlement of personal injury action was open to garnishment by beneficiary's creditors). Although there is language in the written trust that the settlors are Thomas Mars as next friend *and* Zane Mars, the evidence is clear (and Cohen so testified) that the real settlor was Zane alone. This very principle is embodied in the statutes of several states, including Colorado. Section 38--10--111, 10 C.R.S. (1997) provides:

> 38--10--111. **Trusts for use of grantor void against creditors.** All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same *shall be void as against the creditors existing of such person.*

(Emphasis added.) In addition, the Restatement indicates that any attempt by the settlor-beneficiary to transfer, assign, or alienate the income or principal of the trust will be successful. *See* Restatement (Second) of Trusts § 156; IIA *Scott on Trusts, supra,* § 156, at 164--65.

In his supplemental brief, Cohen now argues that the oral spendthrift trust that he created violated both section 38--10--111 and public policy. With respect to section 38--10--111:

> Zane's transfer of settlement proceeds into the oral irrevocable spendthrift trust, while reserving the beneficial interest to himself, would not protect the proceeds from his existing creditors. There is no indication in the record that Zane had any existing creditors at the time the settlement proceeds became subject to the oral trust.

Cohen assumes that section 38--10--111 only applies to creditors of the settlor-beneficiary at the time the trust is created. *See In re Baum,* 22 F.3d 1014, 1017 (10th Cir.1994) (construing section 38--10--111 to apply only to creditors existing at time trust was created). The complainant makes the same assumption, but concludes that while the trust may not be valid as to creditors, it is not thereby void. But even if there were no creditors at the time the trust was settled, the oral irrevocable spendthrift trust could not and did not protect the settlor-beneficiary from future creditors. *See* Restatement (Second) of Trusts § 156; IIA *Scott on Trusts, supra,* § 156, at 164--67. If we were to believe Cohen that he thought he was merely Zane's agent regarding the trust and therefore subject to Zane's orders regarding disposition of the proceeds, we would be forced to conclude that the Trust "was illusory and fraudulent" as against any creditors

of Zane. *See Kaladic v. Kaladic,* 41 Colo.App. 419, 422, 589 P.2d 502, 505 (1978). In *Kaladic,* eleven months before the wife filed a dissolution of marriage action, she established an irrevocable, discretionary, spendthrift trust because of what she viewed as excessive drinking by the husband and because of his statements indicating to her that he was financially irresponsible. *See id.* at 420, 589 P.2d at 504. The wife was the sole income beneficiary and her lawyer was the trustee. *See id.* The court of appeals held:

> Here, the conveyance of marital assets by the wife into an irrevocable, discretionary trust without her husband's knowledge was properly set aside by the trial court. It was illusory and fraudulent as against his rights. The trust assets were subject to division as marital property under § 14--10--113(1), C.R.S.1973, and the trustee held those assets as an equitable trustee.

Id. at 422, 589 P.2d at 505. Neither of the parties has argued that the spendthrift trust was set up as an illusion, a sham, or a fraud. We must therefore conclude, as did Zane and the hearing board, that when the oral trust was created, Cohen shouldered the duty of protecting Zane's assets from wasteful depletion, and the concomitant duty of exercising his own professional judgment as to the advisability of investments to be made by the Trust---for Zane's benefit. This duty prohibited Cohen from making ill-advised loans from the Trust for Zane's father's benefit or Cohen's own benefit. This was the duty that Cohen breached.

Therefore, whether the oral or written Trust was void ab initio is immaterial for disciplinary purposes and we do not reach that question. The important thing is that the board's findings mean that Cohen was required to protect Zane's financial interests and this he could not, and did not, do because of the conflicts of interest that existed when the oral trust was created. Thus, we agree with the hearing board that Cohen's conduct violated DR 5--101(A) (accepting employment when there is a conflict between the exercise of the lawyer's professional judgment and the lawyer's own financial, business, property, or personal interests); and DR 5--105(B) (continuing multiple employment when the exercise of the lawyer's independent professional judgment will be, or is likely to be, affected by the representation of another client, or if the multiple employment is likely to involve the lawyer in representing differing interests).

The remaining issue is the proper level of disciplinary sanction. The hearing board recommended that Cohen be suspended for thirty days. The hearing panel modified the recommended period of suspension to ninety days "given that a thirty-day suspension was too lenient in light of the vulnerability of the respondent's client (the son); the imprudent investments (loans) to the other client (the father); and the heightened conflict created by the indebtedness (for attorney's fees) of the father to the respondent."

Under the ABA *Standards for Imposing Lawyer Sanctions* (1991 & Supp.1992) (ABA Standards), in the absence of aggravating or mitigating factors, "[suspension is generally appropriate when a lawyer knows of a conflict of interest and does not fully disclose to a client the possible effect of that conflict, and causes injury or potential injury to a client." ABA *Standards* 4.32.

In the way of mitigating factors, the board found that Cohen has not been previously disciplined, *see id.* at 9.32(a); he cooperated in these proceedings, *see id.* at 9.32(e); and he is held in high repute in the legal profession and the community, *see id.* at 9.32(g). The aggravating factors concern us, however. His conduct was motivated by a selfish purpose, *see id.* at 9.22(b); he did not, and still has not, actually acknowledged that his conduct was wrongful, *see id.* at 9.22(g); and he has remained insensitive to

Zane's vulnerability.

In *In re Quiat,* 979 P.2d 1029 (Colo.1999), we suspended Quiat for three months for violating DR 5--101(B) (accepting employment if the lawyer knows that he or she will be called as a witness), DR 5--105(A) (accepting multiple employment involving conflicts of interest), and DR 5--105(B) (continuing multiple employment involving conflicts of interest). The conflicts in the Quiat case involved his simultaneous representation of a

debtor, the debtor's estranged wife, and the debtor's children in a bankruptcy. *See Quiat,* 979 P.2d at 1041--42. As in this case, at least a short period of suspension was appropriate. *See id.* at 1043. Although we considered a suspension for thirty days, we found it notable that "Quiat's failure to appreciate and understand the wrongfulness of his conduct mandate a longer suspension." *Id.* We suspended Quiat for three months. Cohen has similarly failed to appreciate the extent of his wrongful conduct. We therefore agree with the hearing panel that a ninety-day suspension is warranted.

III.

Accordingly, we order that Gary Steven Cohen be suspended from the practice of law for ninety days, effective thirty days after the issuance of this opinion. We also order Cohen to pay the costs of this proceeding in the amount of $6,006.42 within ninety days after this opinion is announced to the Attorney Regulation Committee, 600 Seventeenth Street, Suite 200 South, Denver, Colorado 80202--5432.

Justice BENDER does not participate.

Footnotes:

1. A "spendthrift trust" is " 'a trust created to provide a fund for the maintenance of the beneficiary, and at the same time to secure it against his improvidence or incapacity.' 65 C.J. 230." *Newell v. Tubbs,* 103 Colo. 224, 227, 84 P.2d 820, 821 (1938). In general, spendthrift trusts are valid and enforceable in Colorado. *See University Nat'l Bank v. **Rhoadarmer,*** 827 P.2d 561, 563 (Colo.App.1991).

2. Before the hearing board, neither the parties nor their expert trust witnesses raised or discussed the issue of whether a spendthrift trust in which the settlor is also the sole beneficiary was valid. Nor was the issue raised in the parties' original briefs to this court. After the case was submitted to the court, we sua sponte ordered the parties to address the issue of the Trust's validity and the effect on the board's finding and recommendation if the Trust was in fact invalid.

These issues are addressed below.

3. Restatement (Second) of Trusts § 39 (1959) provides that "[e]xcept as otherwise provided by statute, an enforceable trust can be created without a writing."

812 P.2d 1152; IN RE MARRIAGE OF JONES;

In re MARRIAGE OF David JONES, Petitioner/Cross-Respondent, and Patricia L. Jones, Respondent/Cross-Petitioner.

No. 90SC22.

Supreme Court of Colorado, En Banc.

June 17, 1991.

[Copyrighted West material redacted at this point. This is the end of official text of this page. Page numbering jumps forward to where the official text resumes.]

Barry D. Roseman, Denver, for petitioner/cross-respondent.

Mygatt & Bratun, Juliana J. Bratun, Boulder, for respondent/cross-petitioner.

Justice ERICKSON delivered the Opinion of the Court.

We granted certiorari to review *In re Marriage of Jones,* 791 P.2d 1173 (Colo.App.1989). In this dissolution of **marriage**

proceeding, the court of appeals held that the increase in value of a discretionary trust, which named the wife as a beneficiary, was not marital property, but that income derived from the trust during the **marriage** was marital property. We granted certiorari to review the court of appeals holding and on the issue of whether the wife's status as a beneficiary of the trust should be considered an economic circumstance in dividing the marital property. We affirm in part, reverse in part, and remand with directions.

The **marriage** of Patricia and David **Jones** was dissolved in July 1987, after twelve years. The only disputed issue in this dissolution proceeding was the division of marital property. During their **marriage**, the wife became a beneficiary of a testamentary trust created by the will of Lois M. Distel, the wife's mother (Distel trust). The named trustees were the wife's father, Joseph A. Distel, and the First National Bank of Boulder, Colorado. The trustees had uncontrolled discretion to distribute income and principal from the trust to Joseph Distel, the wife, or to the wife's descendants for expenses that the trustees determined to be necessary for their "health, welfare, comfort, support, maintenance and education." The trust was to terminate upon the death of both Joseph Distel and the wife,(fn1) and the trust proceeds were to be distributed to the wife's descendants, if any, otherwise to Lois Distel's heirs.

When originally funded, the trust corpus was valued at $118,378.93. That value increased to $160,519.52 by November 1987, when the judgment and permanent order dividing the Jones' marital property was issued by the district court. During her **marriage** to David **Jones**, the wife received approximately $38,000 in income from the trust.

In June 1981, Joseph Distel purchased a house in Lafayette, Colorado, for $138,500. Shortly

thereafter, the wife and husband moved into the Lafayette house rent free. The couple extensively remodeled the house, both devoting a substantial amount of their own time and physical labor to that renovation. The wife paid for the materials, using the $38,000 she received from the trust. In March 1983, after the renovations were substantially complete, Joseph Distel deeded the house to the wife as her sole and separate property, subject to two deeds of trust and a promissory note. At that time, the house had increased in value to between $160,000 and $177,000. From March 1983 until the date of the decree of dissolution, July 30, 1987, the value of the house appreciated another $15,000.

The trial judge valued the marital estate at $55,000, and ordered distribution of 55% to the wife and 45% to the husband. The court found that neither the increase in the value of the trust corpus nor the increase in value of the Lafayette house between 1981 and March 1983 was marital property.

The court of appeals affirmed the trial court's finding that the increase in value of the trust was not marital property. 791 **P.2d** at 1174-75. The court said, however, that the income received by the wife from the trust was marital property, and because those payments had primarily been used to renovate the house, the increase in the value of the house based on those renovations was marital property subject to division. *Id.* at 1175-76.(fn2) We granted the

husband's petition for certiorari on the issues of whether the appreciation in value of the trust corpus was marital property, and whether the wife's interest in the trust was an economic circumstance. We granted the wife's cross-petition for certiorari on the issue of whether income from the trust was marital property.

I.

The husband claims that the court of appeals erred in holding that the appreciation in value of the trust corpus during the **marriage** was not marital property.

Colorado's Uniform Dissolution of **Marriage** Act, §§ 14-10-101 to -133, 6B C.R.S. (1987 & 1990 Supp.), distinguishes marital and separate property. § 14-10-113. Under section 14-10-113(2), all property acquired by either spouse subsequent to the **marriage** is considered marital property except:

(a) Property acquired by gift, bequest, devise, or descent;

(b) Property acquired in exchange for property acquired prior to the **marriage** or in exchange for property acquired by gift, bequest, devise, or descent;

(c) Property acquired by a spouse after a decree of legal separation; and

(d) Property excluded by valid agreement of the parties.

Section 14-10-113(1) requires an equitable distribution of marital property, regardless of fault, after all relevant factors are considered, including the contributions of each spouse, the value of property set apart to each spouse, the economic circumstances of each spouse, and any increase, decrease, or depletion in the value of any separate property during the **marriage**. *See Carlson v. Carlson,* 178 Colo. 283, 497 **P.2d** 1006 (1972); *In re Marriage of McGinnis,* 778 **P.2d** 281 (Colo.App.1989). Separate property acquired either before the **marriage**, or under subsections 14-10-113(2)(a) or (b), however, is considered marital property, and thus divisible, only to the extent that "its present value exceeds its

value at the time of the **marriage** or at the time of the acquisition if acquired after the **marriage**." § 14-10-113(4); *see In re Marriage of Campbell,* 43 Colo.App. 72, 599 **P.2d** 275 (1979).

Both parties agree that the trust corpus is not marital property and thus not divisible between them. The husband, however, argues that the trust is separate property under subsection 14-10-113(2)(a), and that the increase in value of the trust corpus during the **marriage** is marital property subject to division. Although any appreciation in the value of separate property during a **marriage** is marital property under section 14-10-113, we have said that "there are necessary limits upon what may be considered 'property.'" *In re Marriage of Graham,* 194 Colo. 429, 432, 574 **P.2d** 75, 76 (1978).

In *Graham,* we said that a college degree, while a relevant factor in determining the proper division of property, was not itself "property," either marital or separate. *Id.* at 432-33, 574 **P.2d** at 77-78. "An educational degree, such as an M.B.A., is simply not encompassed even by the broad views of the concept of 'property.' It does not have an exchange value or any objective transferable value on an open market.... It cannot be assigned, sold, transferred, conveyed, or pledged." *Id.* at 432, 574 **P.2d** at 77. *See also Menor v. Menor,* 154 Colo. 475, 482, 391 **P.2d** 473, 477 (1964) (husband's insurance policy with no cash surrender value was not an asset subject to division as "property").

In *In re Marriage of Rosenblum,* 43 Colo.App. 144, 602 **P.2d** 892 (1979), the court of appeals rejected the argument now asserted by the husband. In *Rosenblum,* the husband, while married, was named both a beneficiary and a co-trustee for a trust created by the husband's mother. *Id.* at 145, 602 **P.2d** at 893. During the **marriage**, the trust increased in value from $200,000 to $3,500,000, and the wife claimed that the increase was marital property subject to division. *Id.* The court of appeals rejected that argument, concluding

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that the husband's rights in the trust were not "property" for purposes of section 14-10-113. *Id.* at 147, 602 **P.2d** at 894. As here, the trustees in *Rosenblum* were given absolute discretion to distribute all, any, or none of the trust income or principal, and, so long as the husband was a trustee, no income or principal could be distributed to him in excess of that necessary for his health, education, support, or maintenance.

> Although a beneficiary of such a discretionary trust does have rights therein, those rights are merely an expectancy and do not rise to the level of property....
>
> Husband's rights in the trust have no cash surrender, loan, redemption, or lump sum value, and no value realizable after death. Neither could the corpus or income of the trust be reached by his creditors until a distribution occurred.

Rosenblum, 43 Colo.App. at 146, 602 **P.2d** at 894 (citations omitted).

The court of appeals in *Rosenblum* relied in part on *Ellis v. Ellis,* 191 Colo. 317, 552 **P.2d** 506 (1976), which held that future payments of military retirement pay were not "property" for purposes of section 14-10-113. While acknowledging its applicability, the husband here argues that *Rosenblum* was overruled by *In re Marriage of Gallo,* 752 **P.2d** 47 (Colo.1988), which overruled *Ellis* and held that vested and matured military retirement pay is property under section 14-10-113, and *In re Marriage of Grubb,* 745 **P.2d** 661 (Colo.1987), which held that vested but unmatured employer-supported pension plans are property subject to division.

In *Ellis,* we said that military retirement pay was not marital property because it did not have "any of the following elements: cash surrender value; loan value; redemption value; lump sum value; and value realizable after death." 191 Colo. at 319, 552 **P.2d** at 507. Two years later, we distinguished employee contributions to the Public Employees Retirement Association (PERA) when holding that those contributions were marital property subject to division. *In re Marriage of Mitchell,* 195 Colo. 399, 579 **P.2d** 613 (1978). In *Mitchell,* we emphasized that there was nothing "speculative or uncertain about the husband's right to the money," 195 Colo. at 403, 579 **P.2d** at 616, and then distinguished PERA contributions from military retirement pay on the basis that the military retirement plan in *Ellis* would have no value if the employee died before he retired, and thus its future value was speculative. *Id.* at 403, 579 **P.2d** at 617.

Subsequently, in *In re Marriage of Grubb,* 745 **P.2d** at 664, we rejected the analysis of retirement benefits used in *Ellis* and *Mitchell* and held that a husband's interest in a vested but unmatured employer-supported pension plan was marital property subject to division.(fn3) Rather than look to whether a future contingency, such as death, might divest the husband's interest in the pension, we said that the true nature of retirement benefits, "far from being a mere gratuity deriving from the employer's beneficence, [is] nothing less than a form of deferred compensation---that is, they are consideration for past services performed by the employee and constitute part of the compensation earned by the employee." *Id.* The fact that a vested pension plan does not mature until the employee retires "does not render the plan so speculative as to remove it from the category of marital property." *Id.* at 665. Finally, we said that "the controlling consideration [was] that an employee who is fully vested under a pension plan has a *right* to receive payment at some time in the future." *Id.* Such a right, according to *Grubb,* is not a mere expectancy but instead an enforceable contractual right and thus a form of property. *Id.*

In *Gallo,* we extended the reasoning of *Grubb* to overrule *Ellis* and hold that vested and matured military retirement pay was marital property. 752 **P.2d** at 54. Once again, we relied on the fact that retirement plans were properly part of the

consideration earned by the employee and that as such, the employee had a contractual right to the benefits. *Id.* at 51.

The crux of both *Grubb* and *Gallo* was that the spouse had a vested right to the benefits under both retirement plans that were compensation for employment services rendered. On the other hand, in *In re Marriage of Olar,* 747 **P.2d** 676 (Colo.1987), we reaffirmed our holding in *Graham* that advanced educational degrees were not property for purposes of section 14-10-113 because, while pension rights constitute a current asset that the individual had a contractual right to receive, "the enhanced income resulting from a professional degree is a 'mere expectancy.'" *Id.* at 679-80 (citing *Archer v. Archer,* 303 Md. 347, 355-356, 493 A.2d 1074, 1079 (1985)). Thus, while *Rosenblum's* conclusion that the trust was not property because it had no cash surrender, loan, redemption, or lump sum value, and no value realizable after death, may now be in question, we are not persuaded that its ultimate outcome is no longer valid. Under *Gallo, Grubb,* and *Olar,* the focus of our inquiry is the interest of a spouse in the property at issue.

The Distel trust is completely discretionary. The trust provides that the trustees *may* pay or apply for the benefit of the Joseph Distel, the wife, or the wife's descendants income, principal or both that the trustees, "in their uncontrolled discretion, determine to be necessary or advisable for the health, welfare, comfort, support, maintenance and education of such persons without the necessity of equalization or proration among them." The discretion vested in the trustees is fortified by a provision that the trustees

have "full and uncontrolled discretionary power and authority to ... [d]ivide and distribute my estate and the trusts in kind or in money or partly in each, or by way of undivided interests, even if shares be composed differently, utilizing such valuations as they deem correct." The fact that the trustees are limited to disbursing funds to the wife for only her support, *if* they decide to disburse funds at all, does not deprive the trust of its discretionary character. Nor does the fact that some income has been distributed to the wife, at the sole discretion of the trustees, change the nature of the underlying trust.

Although a beneficiary of a discretionary trust has an equitable interest in the subject matter of the trust, 2 *A. Scott on Trusts* § 130 at 409 (4th ed. 1987), the beneficiary could not force the trustee to pay income or principal unless she could establish fraud or abuse of discretion on the trustees' part.

> Where by the terms of the trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his discretion shall see fit to pay or apply, the extent of the interest of the beneficiary depends on the manifestation of intention by the settlor.... The beneficiary cannot obtain the assistance of the court to control the exercise of the trustee's discretion except to prevent an abuse by the trustee of his discretionary power.... *If the settlor manifested an intention that the discretion of the trustee should be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment.*

2 *A. Scott on Trusts* § 128.3 (emphasis added); *see also Culver v. Culver,* 112 Ohio App. 100, 103-104, 169 N.E.2d 486, 488-89 (1960).

While the wife may have some equitable beneficial interest in the subject matter of the trust, whether she receives money from the trust depends not on a future contingency, but on the sole discretion of the trustees. Thus, unlike a vested retirement plan, the beneficiary of a discretionary trust has no contractual or enforceable right to income or principal from the trust, and cannot force any action by the trustee unless the trustee performs dishonestly or does not act at all. The interest of the beneficiary in a discretionary trust is not assignable and cannot be reached by his or her creditors. G. Bogert, *Trusts,* § 41 (6th ed. 1987). The beneficiary, then, has no vested "property" right to receive

payment from the trust. "Until the trustee elects to make a payment[,] the beneficiary has a mere expectancy." G. Bogert, *Trusts & Trustees,* § 228, at 512-13 (2d ed. 1979). "[W]hether it ripens into a benefit depends on the uncontrolled discretion of the trustee, even though [the beneficiary] may secure something of value if the trustee later elects to pay or apply. Few will extend credit to the beneficiary on reliance on being able to get satisfaction from his *highly speculative interest." Id.* at 515 (emphasis added). *See Matter of Estate of Brooks,* 42 Colo.App. 333, 335-36, 596 **P.2d** 1220, 1221 (1979) (beneficiary of a discretionary trust has no absolute right to any distribution); *cf. Lynch v. Lynch,* 147 Vt. 574, 577, 522 A.2d 234, 236 (1987) (trust created by a spouse who retains a power of revocation is marital property subject to division).

A discretionary trust differs from those trusts that grant the beneficiary some future, vested benefit not within the discretion of the trustee to withhold, but whose value may be uncertain at the time of the dissolution of **marriage**. *See,* e.g., Mey v. Mey, 79 N.J. 121, 125, 398 A.2d 88, 89-90 (1979) (husband entitled to receive his share of principal when he reached the age of twenty-five, which he did during the **marriage**); *Davidson v. Davidson,* 19 Mass. App. 364, 371-373, 474 N.E.2d 1137, 1143-45 (1985) (vested remainder interest that would be distributed to the husband when his mother died and he reached the age of thirty-five); *Trowbridge v. Trowbridge,* 16 Wis.2d 176, 184-187, 114 N.W.2d 129, 134-36

(1962) (husband entitled to payment of the entire principal and undistributed income upon his mother's death). Here, on the other hand, the wife had no right at any time to either the trust corpus or income. It was the wife's descendants, if any, who would receive any undistributed income or principal from the trust upon her and her father's death. We therefore agree with, and affirm, the court of appeals' conclusion that a discretionary trust corpus cannot be considered the separate property of a beneficiary for purposes of division of property under section 14-10-113.(fn4)

II.

We do not agree, however, with the court of appeals' holding that, although the trust corpus was not the wife's separate property, the income she received from the trust was "marital income" subject to division. *Jones,* 791 **P.2d** at 1175. The court stated that under the Uniform **Marriage** and Divorce Act (UMDA), 9A U.L.A. § 307 n. 92 (1987), "income from both marital and non-marital property received during the **marriage** is deemed to be marital property."(fn5) 791 **P.2d** at 1175. The court also relied on cases from other jurisdictions holding that income derived from nonmarital property during the **marriage** is marital property. *Id.*

The court of appeals' reliance on the UMDA was misplaced. The text of section 307 of the UMDA does not differentiate or define marital or nonmarital property, but instead sets out the factors for the trial court to consider when making an equitable distribution of property. Moreover, the text of section 14-10-113, which defines what is separate and marital property, controls in Colorado over the model act.

The cases cited by the court of appeals are, as well, inapposite. The incomes at issue in those cases were derived from what would be classified as separate property in Colorado. *In re Marriage of Reed,* 100 Ill.App.3d 873, 877, 56 Ill.Dec. 202, 205,

427 N.E.2d 282, 285 (1981) (income derived from certificate of deposit acquired by husband prior to the **marriage**); *Sousley v. Sousley,* 614 S.W.2d 942, 943-44 (Ky.1981) (income from stock owned by the husband prior to the **marriage**); *Brodak v. Brodak,* 294 Md. 10, 25-26, 447 A.2d 847, 855 (1982) (income was derived from real property given to the husband as a gift from his parents); *In re Marriage of Williams,* 639 S.W.2d 236, 237 (Mo.App.1982) (income from calves acquired before the **marriage**); *In re Marriage of Arneson,* 120 Wis.2d 236, 243-244, 355 N.W.2d 16, 19-20 (1984) (property purchased with dividend income from stock given to husband as a gift from his father).

Although in Colorado, it is unsettled whether income from, as opposed to an increase in value of, separate property is treated as marital property, that issue is not before us here. The income here was from a trust that was neither the wife's marital nor separate property. For purposes of section 14-10-113, the Distel trust was not the wife's "property" in any sense as she had no right to either the income or principal at any time. Hence, the income received by the wife from the trust is more properly a "gift" under subsection 14-10-113(2)(a), and thus not divisible.

III.

We agree, however, with the husband's contention that the wife's expectancy interest in the trust should be considered an economic circumstance under subsection 14-10-113(1)(c). In *Rosenblum,* after holding that the trust at issue was not "property," the court of appeals said "[the husband's] rights in the trust are to be considered by the court as any other 'economic circumstance' of the husband in determining a just division of the marital property pursuant to § 14-10-113(1)(c)." 43 Colo.App. at 147,

602 **P.2d** at 894. In *Olar,* we said that the contribution of a spouse to the other spouse's educational degree was a "relevant factor" under section 14-10-114 in determining the proper award of maintenance, notwithstanding that the educational degree itself was not "property" within the meaning of section 14-10-113. 747 **P.2d** at 680. The trial court must consider all relevant factors when dividing property, even those factors that might be difficult to gauge, such as the value to the beneficiary of a discretionary trust. *See* § 14-10-113(1); *Carlson v. Carlson,* 178 Colo. at 289, 497 **P.2d** at 1009.

Although the wife points to differences between her interest in the Distel trust and the husband's trust interest in *Rosenblum,* those differences do not prevent the trial court from taking the trust into consideration as an economic circumstance. It is within the trial court's discretion to determine the weight to apply to that circumstance, and the court's findings will not be disturbed unless clearly erroneous. *Mulhollen v. Mulhollen,* 145 Colo. 479, 358 **P.2d** 887 (1961). To the extent that it has already not done so, the trial court on remand should consider the wife's interest in the trust as an economic circumstance.

Accordingly, we affirm that part of the court of appeals opinion holding that the increase in value of the Distel trust corpus is not marital property subject to division, reverse the court of appeals' holding that the income derived from the trust is marital property, and hold that the wife's interest in the trust is an economic circumstance that may be considered. We return this case to the court of appeals with directions to vacate the order for modification of distribution of property, and to remand to the district court for reconsideration of the division of marital property consistent with the views expressed in this opinion.

Justice QUINN dissents in part.

Justice QUINN dissenting in part:

I respectfully dissent from Part I of the court's opinion. Section 14-10-113(4), 6B C.R.S. (1987), states that an asset acquired by either spouse during the **marriage** by gift, bequest, devise, or descent shall be considered as marital property to the extent that its present value exceeds its value at the time of acquisition. The majority holds that any increase in value of the corpus of a testamentary trust during the **marriage** of the beneficiary is not marital

property because the trust was purely discretionary and the beneficiary, Patricia **Jones**, has nothing more than a mere expectancy until such time as the trustees elected to make a payment to her. Maj. op. at 1156-1157. I view the interest of Patricia **Jones** in the testamentary trust as a vested beneficial interest in trust property. Consequently, I would hold that the increase in the value of the trust assets during the **marriage** constitutes marital property under section 14-10-113(4).

In *In re Marriage of Grubb,* 745 **P.2d** 661 (Colo.1987), we held that a husband's interest in a vested but unmatured employer-supported pension plan constituted marital property subject to division in a dissolution proceeding, even though the receipt of benefits under the plan was contingent upon the husband's survival until the actual commencement of retirement. We emphasized in *Grubb* that "[a] rule directed to the disposition of property in a dissolution proceeding can only be as sound as the economic reality which it attempts to service." 745 **P.2d** at 664. Prior to our decision in *Grubb,* we had held in *Ellis v. Ellis,* 191 Colo. 317, 552 **P.2d** 506 (1976), that military retirement pay was not marital property because it lacked any of the following elements: "cash surrender value; loan value; redemption value; lump sum value; and value realizable after death." 191 Colo. at 319, 552 **P.2d** at 507. We had also held

in *In re Marriage of Mitchell,* 195 Colo. 399, 579 **P.2d** 613 (1978), likewise decided prior to *Grubb,* that employee contributions to the Public Employees Retirement Association fund were marital property because there was nothing uncertain about the employee's right to the money, since the employee could quit work and withdraw the contributions. 195 Colo. at 403, 579 **P.2d** at 616. In *Grubb,* we disavowed our prior analysis of marital property in *Ellis* and *Mitchell* because such analysis failed to account for the "economic reality" of the interest in question. *Grubb,* 745 **P.2d** at 664. We went on to conclude in *Grubb* that, although the husband's receipt of pension payments under a vested but unmatured pension plan is contingent on some future event, this contingency "does not render the plan so speculative as to remove it from the category of marital property." 745 **P.2d** at 665. By a similar analysis, the discretionary nature of the testamentary trust in this case does not render Patricia Jones' interest in the increase in the value of the trust corpus so speculative as to render it something other than marital property.

The creation of a trust results "in the creation in the beneficiary of an interest in the subject matter of the trust." *Restatement (Second) of Trusts,* § 74 comment a (1959). An equitable interest in trust property is regarded as a property interest of the same kind as a trust *res* and is more than a mere *chose in action. Senior v. Braden,* 295 U.S. 422, 433, 55 S.Ct. 800, 803, 79 L.Ed. 1520 (1935); *see also Brown v. Fletcher,* 235 U.S. 589, 599, 35 S.Ct. 154, 157, 59 L.Ed. 374 (1915); II W. Fratcher *Scott on Trusts,* § 130 at 406 (1987). In this case, the settlor, Lois Distel, created a testamentary trust which gave the trustees, one of whom was Lois' husband and the other the First National Bank of Boulder, the right to distribute income and invade the principal to the extent "necessary or desirable for the health, welfare, comfort, support, maintenance and education" of Patricia **Jones,** who is Lois' daughter, or Lois' husband. The trustees have no obligation to preserve the corpus of the trust for future beneficiaries, nor are they obligated to equalize or prorate the distributions to the beneficiaries. Patricia Jones' interest in the trust, far from being an unvested future interest, became absolutely vested at the time of her mother's death. While the trustees have discretion in distributing the income and principal, the fact remains that Patricia **Jones** benefitted by the increase in the value of the trust corpus and received approximately $38,000 from the trust over a period of five years during her **marriage.** This substantial distribution belies the notion that her interest in the trust corpus was a mere expectancy rather than a property interest.

Where, as here, a spouse has a vested beneficial interest in a testamentary trust and receives substantial trust income during

the **marriage,** the spouse's vested beneficial interest constitutes a property interest in the subject matter of the trust, with the result that any increase in value of the trust corpus should be subject to division as marital property pursuant to section 14-10-113(4). Several courts in other jurisdictions have concluded that a spouse's interest in future benefits, in some cases less certain than Patricia Jones' interest in the trust under consideration, was subject to division in a dissolution proceeding. In *Davidson v. Davidson,* 19 Mass.App. 364, 474 N.E.2d 1137 (1985), for example, a father established a testamentary trust for his wife with the remainder interest in his married son. Because the trustees had uncontrolled discretion to invade the principal for the benefit of the settlor's wife, the married son's remainder interest was uncertain. The court nevertheless concluded that the married son's remainder interest under the testamentary trust, "while it may have been at the outer limits, constituted a sufficient property interest" to make it part of the married son's marital estate for purposes of property division. Id. at 1144. Neither the "uncertainty of value" nor the "inalienability" of the married son's interest by virtue of a validspendthrift clause were sufficient "to preclude consideration of the interest as subject to division." Id. (footnote omitted). In *Trowbridge v. Trowbridge,* 16 Wis.2d 176, 114 N.W.2d 129 (1962), a father created a life estate in his wife and a remainder interest in his married son after the death of the settlor's

wife and the married son's attainment of the age of forty years of age, with the settlor's wife having power to invade the principal under certain conditions. Despite the fact that the married son could possibly receive nothing under the trust, the court "had no doubt" that the son's interest was subject to division in a divorce proceeding, 114 N.W.2d at 134; *cf. McGinley v. McGinley,* 388 Pa.Super. 500,565 A.2d 1220 (1989) (husband's vested future interest in testamentary trust was "property," even though husband's right to receipt of the trust corpus was subject to divestment if he did not survive his father; because, however, husband's interest vested at his birth, it was not "marital property" under Pennsylvania statute defining such property as property acquired during **marriage**).(fn1)

Although the issue of apportioning the increase in the value of the trust during the **marriage** to Patricia **Jones** may present a somewhat difficult question, similar difficulties in valuation are faced by trial courts every day. As in the case of valuing prospective pension payments, a court can employ any of several alternatives. One alternative might to place a value on Patricia Jones' interest in the increased value of the trust corpus by utilizing a table similar to that for valuing a remainder interest for purposes of estate taxes. *McCain,* 219 Kan. 780,549 **P.2d** 896, 900 (1976). Another alternative might consist of ordering a percentage of future funds received by the beneficiary to be paid over to the other spouse. *Trowbridge,* 114 N.W.2d at 134. Other alternative methods can be employed, based on a trial court's "experience, insight and knowledge." *Davidson,* 474 N.E.2d at 1145, n. 12.

I would reverse the judgment of the court of appeals and hold that Patricia **Jones** has a vested beneficial interest in her mother's testamentary trust, that such interest is a property interest, and that any increase in value of the trust corpus during her **marriage** is "marital property" subject to division in a dissolution proceeding. I accordingly dissent from Part I of the court's opinion.

Footnotes:

1. Article V, section 3, of the trust provision contained in Lois Distel's will provided:

> This trust shall terminate (unless all principal is sooner paid out in accordance with the discretionary powers above granted in Section 2) upon the fulfillment of whichever of the following conditions shall first occur:
>
> (a) Upon the death of the last survivor of my husband, Joseph, and my daughter, Pat, provided that all of the children of my said daughter then living shall have attained the age of twenty-one (21) years;
>
> (b) When all of the children of my said daughter then living shall have attained the age of twenty-one (21) years, provided that my said husband and said daughter shall have died prior to such time;
>
> (c) Upon the death of the last survivor of my said husband and my said daughter, and all of the children of my said daughter who are living at the time of my death.

2. The court of appeals also held that the trial court had failed to properly consider the value of the husband's labor expended in renovating the house, and hence his contribution to the house's appreciation before March 1983. The court remanded the case for reconsideration by the trial court on that question. That issue is not before us, nor do we address it, and the court of appeals remand to the district court on that issue must be followed.

3. "Vesting" occurs when an employee completes the minimum required terms of employment necessary to receive retirement pay at some future time; a vested right "matures" when the employee reaches retirement age and elects to retire. *Grubb,* 745 **P.2d** at 665.

4. We do not address whether vested interests in trusts subject to divestment would be either marital or separate property for purposes of section 14-10-113. Other jurisdictions vary significantly when determining what interests constitute property subject to division in divorce proceedings. For a discussion of different approaches, see *Davidson,* 19 Mass.App. at 372-373 n. 11, 474 N.E.2d at 1143-45 n. 11; *see also Powell v. Powell,* 395 Pa.Super. 345, 353-357, 577 A.2d 576, 580-82 (1990) (holding that, despite earlier ruling that nonvested and vested pensions were marital property, increase in value of vested trusts subject to divestment was not marital property).

5. Note 92 is a compilation of cases analyzing property subject to division from various jurisdictions.

1. In addition to our decision in In **re Marriage** of Grubb, 745 **P.2d** 661 (1987), other Colorado cases have recognized that the value of marital property need not be immediately ascertainable in order to be subject to division. For example, the court of appeals in In **re Marriage** of Fields, 779 **P.2d** 1371 (Colo.App.1989), held that an unliquidated personal injury claim arising during **marriage** is marital property. In another case, the court of appeals held that an attorney's contingency fees were valuable contract rights and as such constituted part of his marital estate, even though the fees were payable after dissolution. In **re Marriage** of Vogt, 773 **P.2d** 631 (Colo.App.1989).

In re Marriage of Kaladic, 589 P.2d 502, 41 Colo. App. 419 (Colo.App. 10/19/1978)

[1] Colorado Court of Appeals

[2] No. 77-914

[3] 589 P.2d 502, 41 Colo. App. 419, 1978.CO.40112 <http://www.versuslaw.com>

[4] Decided: October 19, 1978.

[5] **IN RE THE MARRIAGE OF GRACE M. KALADIC AND LOUIS D. KALADIC**

[6] Appeal from the District Court of El Paso County, Honorable William E. Rhodes, Judge.

[7] Shuey & O'Malley, P.C., Phil J. Shuey, Holme, Roberts & Owen, William S. Huff, for appellant.

[8] Larry D. Myers, for appellee.

[9] Opinion by Judge Sternberg. Judge Enoch and Judge Kelly concur.

[10] Sternberg

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[11] During the course of discovery proceedings attendant to this dissolution of marriage action, the husband learned that prior to filing this action, the wife had established a trust with herself as sole beneficiary. In its decree, the trial court divided the property between the parties and, as an incident to that division, ordered the trustee to convey $26,000 from the trust to the husband. Disputing the jurisdiction of the court to reach the corpus of the trust and to dispose of property held by a trustee not a party to the proceedings, and also asserting that the court erred in its valuation of the trust assets, the wife appeals. We affirm.

[12] The trial court found, on supporting evidence, that both parties had been employed during the 22 years of this childless marriage, she as a school teacher and he as a glazier. Their earnings were merged in various accounts and were properly considered to be marital assets. The wife had control of the financial affairs of the parties during the marriage and gave the husband a weekly allowance of between $10 and $30.

[13] Eleven months before filing this dissolution action, the wife established an irrevocable, discretionary spendthrift trust because of what she viewed as excessive drinking by the husband and his statements indicating to her that he was financially irresponsible. She was the sole beneficiary and her lawyer the trustee.

[14] At the time of the hearing in this case, the trial court had before it a complete disclosure of the assets of the parties, including reports and testimony of the trustee with respect to the trust. The court gave the husband a 40% interest in the residence of the parties; however, because the wife was allowed to reside in it, realization of his percentage interest was delayed until she sold the home or died. Apparently to achieve an equitable balance in the real estate division, the husband was given a residential lot. Of the approximate $100,000 value of the trust, he was awarded $26,000.

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The personal property was divided between the parties on an equitable basis. The court specifically mentioned that it was considering the differences of values of assets awarded each party as a factor in making the cash award from the wife's trust to the husband.

[15] The findings of the trial court are not completely clear with respect to the exact date used for valuation of the trust assets, see In re Marriage of Femmer, 39 Colo. App. 277, 568 P.2d 81 (1977); nevertheless, here a remand for the purpose of making more specific findings in that regard would be futile. The figures used by the court in valuing the trust are approximations, but the amount distributed to the husband would have been within the discretion of the trial court even had the total value of the trust estate varied a few thousand dollars one way or the other. Moreover, the lack of certainty as to the exact value of the trust assets is attributable to the wife. Her attorney, the trustee, submitted a statement of an accounting which omitted one page, and in his testimony at trial, he was unable to reconcile relatively minor inconsistencies in the value of the assets. Considering these factors, we conclude that any deficiency in the findings of the trial court was in no way prejudicial to the wife who is attempting to question them.

[16] The principal issue raised by this appeal is whether the court had jurisdiction to reach the trust assets and require a conveyance of a portion of them to the husband. We hold that the court had such power and properly exercised it in this case. We hold also that, under the circumstances present here, the court had jurisdiction to order the trustee to make payments from the trust to the husband.

[17] Section 14-10-113, C.R.S. 1973, directs the court in a dissolution of marriage proceeding to "set apart to each spouse his property and [to] divide the marital property . . . in such proportions as the court deems just . . . ." The court is to consider the contribution of each spouse to acquisition of the property; the value of the property set apart to each; the

economic circumstances of each; and any increases or decreases in the value of separate property. Here the court found, based upon evidence in the record, that the trust was established by using properties the wife owned before the marriage as well as marital assets. The court in its computations did set aside property owned by the wife prior to marriage.

[18] Generally, one spouse has the right to make inter vivos transfers of property to any person. See In Re Questions Submitted by United States District Court, 184 Colo. 1, 517 P.2d 1331 (1974). However, for the transaction to be valid it must be bona fide and not colorable. See Estate of Barnhart, 194 Colo. 505, 574 P.2d 500 (1978). We find applicable here the language of the Supreme Court in Smith v. Smith, 22 Colo. 480, 46 P. 128 (1896), which was quoted with approval in Scavello v. Scott, 194 Colo. 64, 570 P.2d 1 (1977):

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"[W]here, as here . . . the transaction complained of is colorable only and resorted to by the husband for the purpose of defeating his wife's right as his heir, he hoping thereby to obtain the full benefit of the property to the last hour of his life, and at the same time being able to deprive her of all interest therein as his heir, is as much of a fraud on the part of the husband as it is for a debtor, having in contemplation the incurring of an indebtedness, to put his property beyond his control . . . ."

[19] Here, the conveyance of marital assets by the wife into an irrevocable, discretionary trust without her husband's knowledge was properly set aside by the trial court. It was illusory and fraudulent as against his rights. The trust assets were subject to division as marital property under § 14-10-113(1), C.R.S. 1973, and the trustee held those assets as an equitable trustee. See Page v. Clark, 40 Colo. App. 24, 572 P.2d 1214 (1977).

[20] The wife also contends that the trial court did not have jurisdiction to order the attorney-trustee to make payments from the corpus of the trust because he appeared in court only in the representative capacity of attorney and trial counsel, and not as trustee. It has been held that a court may not order a non-party trustee to convey trust assets in a domestic relations case unless that trustee is joined as a party. Morgan v. Morgan, 139 Colo. 545, 340 P.2d 1060 (1959). The facts present in this case, however, make it distinguishable from Morgan. Not only was the trustee present here at all stages of the proceedings as the wife's attorney, and thus an officer of the court, but also the following statement was made to this attorney-trustee in open court:

[21] "Mr. Shuey, I think it will be your option, I will not have you named as a party in this case as trustee, I don't think it should be necessary."

[22] No response to this statement by the attorney-trustee appears in the record. Where the trustee of a fraudulent trust is the attorney of record for one of the parties who is the settlor and sole beneficiary of the trust, and the court addresses the problem regarding the possible

need to join the trustee as a party, we do not countenance the attorney, an officer of the court, using his silence as a shield and asserting on behalf of the wife that the order is void. His silence constituted a waiver of the requirement that he be served with process to join him as trustee in this lawsuit. He thereby subjected himself as trustee to the jurisdiction of the court.

[23] The husband requests that we award attorney fees for actions he was required to take after the entry of judgment by the trial court. We remand this request to the trial court for its consideration.

[24] Judgment affirmed and cause remanded for further proceedings relating to attorney fees, if any, to be awarded to the husband.

[25] Disposition

[26] Affirmed.

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996 P.2d 1281; LAGAE V. LACKNER;

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Ina M. LAGAE, Petitioner, v. Edward J. LACKNER, individually; Doris K. Lackner, individually; and Richard I. Kornfeld, individually, Respondents.

No. 98SC593.

Supreme Court of Colorado, En Banc.

March 27, 2000.

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Rothgerber Johnson & Lyons, LLP, James R. Walker, Justin D. Gumming, Denver, Colorado Attorneys for Petitioner.

Preeo, Silverman & Green, P.C., Jersey M. Green, Denver, Colorado Attorney for Respondents.

Justice HOBBS delivered the Opinion of the Court.

We granted certiorari to review the court of appeals opinion in *Lackner v. King,* 972 P.2d 690 (Colo.App.1998).(fn1) This appeal arises out of the attempted seizure of trust property to satisfy a co-trustee's individual debts. Judgment creditors sought satisfaction of their judgments based on a personal representative's deed to the co-trustee "as trustee" that did not identify the beneficiaries of the trust or reference a document of record containing such information, as provided by section 38--30--108, 10 C.R.S. (1999). We hold that this statutory section does not allow judgment creditors to satisfy their judgments from trust property when they did not rely on the non-conforming personal representative's deed in extending credit to the individual serving as trustee. Thus, we reverse the judgment of the court of appeals and uphold the trial court's refusal to enforce the creditors' notices of levy and seizure,

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although for different reasons than those provided by the trial court.

I.

On April 10, 1987, James Yves Adolph Marie Lagae (J.Y. Lagae) executed a trust agreement establishing the J.Y. Lagae Revocable Trust. The trust agreement named Paul W. King (King) and Darrell Beck, Jr. (Beck) as trustees. It also provided that J.Y. Lagae's wife, Ina May Crafton Lagae (Ina Lagae), would be the sole beneficiary of the trust during her lifetime.

Upon his death, J.Y. Lagae's will contained a pour-over provision directing the residuary of his estate to be transferred to the J.Y. Lagae Revocable Trust. On December 31, 1993, Ina Lagae, as Personal Representative of J.Y. Lagae's estate, transferred the disputed property, a ranch consisting of three parcels of real property located in Douglas County, to the trust. Ina Lagae executed a personal representative's deed identifying "Paul W. King and Darrell Beck, Jr., Trustees of the J.Y. Lagae Revocable Trust," as grantees. The deed also identified the case number for J.Y. Lagae's probate case

pending in Douglas County. In addition, the deed stated that it was for "probate purposes." The deed did not identify, on its face, the beneficiaries of the trust or reference a document of record containing such information.

On January 5, 1995, Ina **Lagae** recorded the personal representative's deed with the Clerk and Recorder of Douglas County. In addition to recording the deed, Ina **Lagae** also filed a Trust Registration Statement(fn2) and an Affidavit of Trust(fn3) with the Clerk of the District Court of Douglas County on March 6, 1995.

In May of 1995, Edward J. **Lackner**, Doris K. **Lackner** and Richard I. Kornfeld (collectively, "the creditors") filed a complaint against King, alleging that King had defaulted on six unsecured promissory notes executed between him and the creditors during the period of March 1, 1994 to October 12, 1994. The district court entered default judgments in July and August, 1995, after King failed to answer the complaints. The judgments entered against King totaled $324,990.86, exclusive of attorney's fees, accrued interest, and costs.

On December 23, 1995, the judgment creditors served King with notices of levy or seizure of the trust property. Ina **Lagae** intervened in the suit and moved to set aside the notices on the basis that the property was held in trust and she was the sole beneficiary during her lifetime. She claimed that King had no equitable title to the property and, thus, the creditors could not satisfy their judgments from it.

The trial court ruled that (1) the notices of levy or seizure must be set aside; and (2) the judgment lien had not attached to the property. The trial court observed that the personal representative's deed did not comply with section 38--30--108 because it did not identify the beneficiaries of the trust. It found, however, that the affidavit of trust constituted prima facie evidence of the facts contained within it and gave notice to the world that the property described in the deed was part of the trust, thus satisfying the requirements of section 38--30--108. Because King had no ownership in the trust property and held it in his fiduciary capacity, the trial court concluded that the creditors could not seize the property in satisfaction of their judgments against King in his personal capacity.

The creditors appealed. The court of appeals held that the trial court erred in concluding that the affidavit of trust cured the failure of the personal representative's deed to identify the beneficiaries of the trust. It ruled that section 38--30--108 specifically required either the beneficiaries to be named in the personal representative's deed or the deed to reference another recorded document

which would provide such information. Because the personal representative's deed failed to meet these requirements, the court of appeals held that the creditors could reach the trust property to satisfy the personal judgments against King.

We reverse the judgment of the court of appeals and uphold the trial court's refusal to enforce the creditors' notices of levy or seizure.

II.

We hold that the failure of a personal representative's deed to list the beneficiaries of a trust or reference a document of record providing such information, pursuant to section 38--30--108, does not render trust property available to satisfy personal judgments against a trustee when the creditors placed no reliance on the non-conforming personal representative's deed in extending the credit.(fn4)

A. Intent and Purpose of Section 38--30--108

A fundamental tenet of trust law is the protection of the trust estate from a trustee's personal creditors. *See* George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 146, at 54 (2d rev. ed.1993). The creditors here do not argue that they are creditors of the J.Y. Lagae Trust; rather, they are judgment creditors of King as an individual.

In interpreting a statute, we must give effect to the intent of the legislature. *See AviComm, Inc. v. Colorado Pub. Util. Comm'n,* 955 P.2d 1023, 1031 (Colo.1998). In doing so, we presume that the General Assembly intended a just and reasonable result. *See id.;* § 2--4--201(1)(d), 1 C.R.S. (1999). We construe the various parts of a statute to give consistent, harmonious, and sensible effect to the statute as a whole. *See Cooper v. People,* 973 P.2d 1234, 1239 (Colo.1999). Thus, we will not adopt a statutory interpretation that defeats legislative intent. *See AviComm,* 955 P.2d at 1031. Although we must give effect to the statute's plain and ordinary meaning, the General Assembly's intent and purpose must prevail over a literalist interpretation that leads to an absurd result. *See id.*

Section 38--30--108 sets the guidelines for conveying property, including trust property, to a party in a representative capacity. It provides:

> All instruments conveying real estate, or interests therein, in which the grantee is described as trustee, agent, conservator, executor, administrator, or attorney-in-fact, or in any other representative capacity, *said instruments shall also name the beneficiary so represented and define the trust or other agreement under which the grantee is acting, or refer, by proper description to book, page, document number, or file* to an instrument, order, decree, or other writing which is of public record in the county in which the land so conveyed is located in which such matters appear; *otherwise the description of a grantee* in any such representative capacity in such instruments of conveyance *shall be considered and held a description of the person only and shall not be notice of a trust or other representative capacity of such grantee.*

§ 38--30--108 (emphasis added).

Here, the personal representative's deed named King and Beck as co-trustees of the J.Y. Lagae Revocable Trust, but the deed did not list the beneficiaries of the trust. The trial court, determining that the beneficiaries were not listed, then looked to the public record to ascertain whether the deed otherwise complied with section 38--30--108. It found that the affidavit of trust sufficiently met the requirements of section 38--30--108 because it provided notice that the property described was part of the trust. The court of appeals disagreed with this reasoning. Because the deed did not reference the affidavit of trust, the court of appeals determined the deed to be non-compliant with section 38--30--108's requirement that the conveying instrument "refer by proper description to book,

page, document number, or file" to an instrument of public record.(fn5) Thus, it concluded that the unsecured creditors of King in his personal capacity should be allowed to levy upon and seize the trust property.

We determine that the court of appeals' reading of section 38--30--108 leads to a result not intended by the General Assembly. The legislature's intent in enacting this section was to give credence to actions of a trustee in selling, pledging as collateral, or otherwise dealing with trust property. Many states

enacted statutes similar to section 38--30--108 to counteract the tendency of property to be considered inalienable when it had an "as trustee" grantee in its chain of title. Under the common law, when a conveyance of land was made to a person as trustee and there was nothing further to indicate the existence of a trust, the form of the instrument was held sufficient to indicate that the land was or may be held in trust. *See* Austin Wakeman Scott & William Franklin Fratcher, *The Law of Trusts* § 297.3, at 118 (4th ed.1989). In Colorado, for example, prior to the enactment of section 38--30--108, the supreme court held that "the word 'trustee,' ... indicates the intention of the parties that the grantee was to take the title, not in his individual capacity, but *in trust* for another, though the name of his *cestui que trust* is not disclosed by the deed." *Johnson v. Calnan,* 19 Colo. 168, 177, 34 P. 905, 908 (1893) (emphasis in original).

If a trustee breached his or her duty to the trust and a transferee could have ascertained such facts through reasonable inquiry, the transferee took subject to the trust. *See* Scott & Fratcher, *supra,* at 118. This standard of diligent inquiry significantly detracted from the alienability of property and the willingness of third parties to enter into transactions. *See* Annotation, *Effect of Deed in Which the Word "Trustee" Follows the Name of Grantee, but Does Not Set Out Terms of Trust or Name of Beneficiary,* 137 A.L.R. 460, 461--62 (1942). Purchasers and lenders were refusing to deal with the trust property or the trustee unless it was shown that (1) no trust existed or (2) the trustee specifically had a power of sale. *See* Scott & Fratcher, *supra,* at 118. Colorado, like other states, enacted statutes so that

> where the word "trustee" is added to the name of the grantee in a deed of conveyance of land in which no beneficiaries are named, and the purposes of the trust are not set forth in the deed and no other "instrument showing a declaration of trust is recorded, a *purchaser of land* takes it free of any trust.

Id. at 118--19 (emphasis added).

B. Inapplicability of Section 38--30--108 to a Trustee's Unsecured Personal Creditors who did not Rely on the Non-Conforming Instrument

A personal representative's deed in the course of probate is within the ambit of section 38--30--108. A personal representative has "the same power over the title to property of the estate that an absolute owner would have, in trust however, for the benefit of the creditors and others interested in the estate." § 15--12--711, 5 C.R.S. (1999). The purpose of a personal representative's deed, in the context of assets intended by the decedent to be placed in trust, is to provide evidence of the conveyance of such assets to the trust in accordance with the will's provisions, so that the trustee may act for the beneficiaries in accordance with the terms of the trust.

Because we, have not previously construed section 38--30--108, we look to the experience of other states in construing and applying similar statutes. We hold that section 38--30--108 is a notice statute. Pursuant to its terms, Ina Lagae's personal representative's deed should have included designation of the trust's beneficiaries or referred to a public record containing such information. The statute's purpose in the context of trust assets is to allow third parties to rely on the trustee's actions in connection with the trust property, without having to determine

whether the trustee is or is not complying with his or her fiduciary duty to the trust beneficiaries. When the instrument does not identify the beneficiaries or reference the public record containing such information, and is therefore non-compliant with the statutory notice requirement, the statute (1) protects

subsequent takers by eliminating their duty of inquiry to ascertain the nature and effect of a trust relationship; and (2) prevents the undisclosed beneficiaries from contesting the interest of subsequent takers who obtained the property from the trustee or through the trustee's chain of title.

1. Construction and Application of Similar Statutes

In states with statutes similar to section 38--30--108, courts have held them to be notice statutes that prevent the undisclosed beneficiaries from contesting the interest of subsequent takers who relied on the non-conforming instrument. In *State v. Thibert,* 279 N.W.2d 53, 58 (Minn.1979), for example, the Minnesota Supreme Court held that the purpose of Minnesota's statute was to protect subsequent purchasers where the recorded instrument to the trustee failed to provide adequate notice of trustee powers and beneficiary rights. In so holding, it declined to allow a creditor to attach its lien to the trust property when the creditor had not examined the title or relied on the non-conforming instrument in extending credit. *See id.*

Likewise, the Ohio Supreme Court held that its statute also served as a notice statute. *See Marital Trust Under the Will of Casto v. Lungaro,* 22 Ohio St.3d 298, 490 N.E.2d 599, 600 (1986). The court stated that "[n]on-compliance with the statute does not defeat the creation of an equitable interest; it simply prevents enforcement of that interest against the particular parties named in the statute." *Id.; see also Erskine v. Elliott,* 140 Or.App. 500, 916 P.2d 319, 322 (1996) (court held that statute protects subsequent takers from a trustee by eliminating their duty of inquiry to ascertain the nature and effect of a trust relationship and prevents undisclosed beneficiaries from challenging facially valid title but does not otherwise alter the law regarding the devolution of title).

Florida's statute provides that a non-conforming instrument "shall grant and is hereby declared to have granted a fee simple estate with full power and authority in and to the grantee in such deed to sell, convey and grant and encumber both the legal and beneficial interest in the real estate conveyed." Fla. Stat. ch. 689.07(1) (1999). Nevertheless, in *Beckham v. Rinker Materials Corp.,* 662 So.2d 760 (Fla.Dist.Ct.App.1995), the court refused to apply this statute to judgment creditors who had not relied on record title of the non-conforming instrument in extending credit:

> [T]he record demonstrates that [the judgment creditor] did not rely on the record title in extending credit to [the trustee]: [the judgment creditor] concedes that it did not search the public records and that it had no knowledge that [the trustee] had any interest in this particular property. Thus, the judgment liens do not attach to the property.

Beckham, 662 So.2d at 762.

Some states have specifically legislated that only purchasers, lessees, mortgagees, or assignees of the trust property, and not a trustee's individual creditors, may rely on the non-conforming instrument to the trustee. *See, e.g.,* Mont.Code Ann. § 70--21--307 (1999) ("shall have no force or effect in charging any purchaser or encumbrancer thereof with notice"); Neb.Rev.Stat. § 76--268 (1999) ("a purchaser from such trustee shall not be bound to inquire or ascertain the terms of the trust"); Ohio Rev.Code Ann. § 5301.03 (Banks-Baldwin 1999) ("subsequent bona fide purchasers, mortgagees, lessees, and assignees for value"). When statutes mention creditors, benefit of the statute is limited to creditors who relied on the trustee's apparent ownership of the property to extend credit. For example, New York's statute states that noncompliance with its requirements "does not defeat the title of a purchaser from the trustee for value and without notice of the trust, or the *rights of a creditor who extended credit to the trustee in reliance upon his apparent ownership of the trust*

property." N.Y. Est. Powers & Trusts Law § 7--3.2 (McKinney 1999) (emphasis added).

Other states have enacted statutes that specifically prohibit a trustee's individual creditors from reaching trust property. See Tex. Prop.Code Ann. § 101.002 (West 1999) ("Although trust property is held by the trustee without identifying the trust or its beneficiaries, the trust property is not liable to satisfy the personal obligations of the trustee."); Wyo. Stat. § 34--2--122 (1999) ("Trust property in the name of the trustee, agent or representative and owned only in that capacity shall not be subject to execution for the grantee's individual obligations.").

Instructed by the experience of other states with statutes similar in purpose to Colorado's, we hold that the intent and purpose of our General Assembly in enacting section 38--30--108 did not include allowing personal judgment creditors to seize trust assets to satisfy a trustee's personal obligations when those creditors did not rely on the non-conforming instrument in extending the credit. To determine otherwise would produce an absurd result. In enacting this statute, the General Assembly, like the legislatures of other states, responded to the problems faced by bona fide purchasers, lessees, mortgagees, or assignees that relied on the apparent authority of trustees. It did not intend to make trust property available to the unsecured creditors of a person who serves as a trustee for another, when those creditors placed no reliance on the non-conforming instrument in making their loans.

2. Lack of Reliance by Trustee's Personal Judgment Creditors

Here, the creditors who attempted to collect on King's personal debt through levy and sale of the ranch property loaned money to him prior to the recordation of this deed.(fn6) They acknowledge that they did not rely on the personal representative's deed or on the underlying property in making their unsecured loans to King.(fn7) The creditors looked to rely on the deed only when they sought execution against the trust property. To allow them to seize trust property after making their unsecured loans to King in his individual capacity under such circumstances would contravene the purpose of trusts and the legislative intent of section 38--30--108.

The creditors argue that *Board of County Commissioners of County of Pitkin v. Blanning,* 29 Colo.App. 61, 479 P.2d 404 (1970), supports their position that the deed to the trustee's failure to comport with the requirements of section 38--30--108 allows them to seize the trust property. We disagree.

In *Blanning,* a dispute arose over title to property that had once been deeded to "George E. Ross Lewin, Trustee." Ross Lewin took title as trustee in 1894 and died in 1905. The property then passed under his will to his daughter. When Lewin's daughter died, she left the remainder of her property, including the subject property, to Northern Trust Company of Chicago. By quitclaim deed, the Trust Company conveyed the property to the Board of County Commissioners, plaintiffs in the dispute. The quiet-title action at issue in *Blanning* was filed in 1968. The court of appeals precluded defendants, who obtained an interest in the property pursuant to a 1956 tax sale, from prevailing. The court of appeals concluded that the 1894 deed vested title in George E. Ross Lewin personally because of the lack of specificity in the deed or in a corollary affidavit about trust beneficiaries.

Blanning substantially differs from the case at hand. The plaintiffs who obtained title to the property via the trustee's chain of title relied upon the non-conforming 1894 deed. The 1894 deed represents precisely the problem our notice statute was designed to address. Our statute is intended to protect the alienability of property and the integrity of the chain of title. It is not intended

to defeat the interests of beneficiaries in favor of a trustee's personal unsecured creditors who placed no reliance on the non-conforming instrument in extending the credit.

III.

Accordingly, we reverse the judgment of the court of appeals and remand this case to it with directions to reinstate the trial court's order quashing and setting aside the notices of levy or seizure and return this case to the trial court for further proceedings consistent with this opinion.

Justice RICE does not participate.

Footnotes:

1. We granted certiorari on the following issues:

   1. Whether a trust beneficiary's property held in trust can be seized by a trustee's individual creditors where the trustee is not a beneficiary and in a manner contrary to the intentions and expectations of the trust's settlor.

   2. Whether the court of appeals erred in applying § 38--30--108, 10 C.R.S. (1999), a notice statute covering instruments conveying real property, to a personal representative's deed which, according to the Colorado Probate Code, does not convey real estate.

   3. Whether the court of appeals erred in holding that failure to comply with § 38--30--108, 10 C.R.S. (1999), allows a trustee's individual creditors to seize trust property.

2. The Trust Registration Statement, dated January 26, 1995, identified the existence of the J.Y. Lagae Revocable Trust, noted the date of the trust agreement, and identified the trustees, in accordance with section 15--16--101, 5 C.R.S. (1999).

3. The Affidavit of Trust, dated January 26, 1995, defined the trust, identified the trustees, and confirmed the authority of the trustees to convey real property held by the trust, in accordance with section 38--30--166, 10 C.R.S. (1999).

4. We do not address the circumstance where a creditor specifically relied upon the non-conforming instrument and the trustee's presumed outright ownership of the property in extending the credit. This case presents no such circumstance.

5. We do not address the trial court's conclusion that the affidavit of trust was adequate notice of the existence of the trust, as we determine that section 38--30--108 is inapplicable to judgment creditors of the trustee who did not rely on the non-conforming conveyancing instrument in extending credit.

6. King's unsecured promissory notes were executed between March 1 and October 12, 1994. Ina Lagae's personal representative's deed was recorded on January 5, 1995.

7. The creditors argued before this court that King acted as a wealthy individual and made verbal representations that he owned the ranch property. In extending credit, however, the creditors decided to

make an unsecured loan without looking to the property as security, and they did not search the public records regarding the title to this specific property.

847 P.2d 184; GOSS V. McCART;

In the Matter of the ESTATE OF Dorothy F. McCART a/k/a Dorothy Frances McCart, Deceased. Robert D. GOSS, Trustee-Appellant, v. Charles H. McCART, Appellee.

No. 91CA0900.

Colorado Court of Appeals, Div. III.

August 27, 1992.

Rehearing Denied Oct. 15, 1992.

Certiorari Denied Feb. 22, 1993.

[Copyrighted West material redacted at this point. This is the end of official text of this page. Page numbering jumps forward to where the official text resumes.]

Naylor & Geisel, P.C., Henry J. Geisel, Pueblo, for trustee-appellant.

Shaw & Quigg, P.C., David B. Shaw, Marc Lassman, Pueblo, for appellee.

Opinion by Judge SMITH.

In this action under § 15--16--201, C.R.S. (1987 Repl.Vol. 6B) concerning the administration and distribution of the Dorothy F. McCart Trust, Robert Goss, Trustee, appeals the order entered in favor Charles McCart, lifetime trust beneficiary. We affirm.

In 1981, Dorothy F. McCart, as settlor and as trustee, and Goss, as the other named trustee, signed a trust agreement. The agreement provided in pertinent part that settlor's spouse, McCart, would be the lifetime beneficiary of the trust and that, upon his death, the trust would be divided 50% to Goss and his descendants and 50% to his brother, David Goss, and his descendants.

McCart and settlor had been married 22 years when settlor died in 1985. In September 1986, McCart remarried.

Following settlor's death and until January 1987, a 16-month period, Goss paid McCart $2000 a month from the trust. From January 1987 through March 1988, McCart was paid $1000 a month. Except for an April 1988 payment, McCart continued to receive this amount until August 1988. Only four payments of $1000 each were made during 1989. In August 1990, payment resumed at $500 a month through January 1991.

The distributions were made under trust provisions which directed Goss, as trustee, to make payments to McCart from the income and principal of the trust. The amounts and frequency of the payments were left to the sole discretion of the trustee. However, concurrent with this grant of authority to the trustee, the trust expressly provided that it was settlor's "wish" that McCart have liberal access to the funds of the trust. The trust provisions

further suggested to the trustee that preservation of the trust principal was not as important as the accomplishment of the following objectives: (1) that the trust provide for the comfortable support, medical care, and other benefits of settlor's spouse, having regard for his other means of support, and (2) that the trust provide settlor's spouse with the standard of living to which he was accustomed.

Because of Goss' irregular payments, **McCart** petitioned the trial court to construe the distribution provisions of the trust and to have payments reestablished on a regular basis. Goss also petitioned for construction of these terms, acknowledging that the trustee and beneficiary had had some differences of opinion regarding the discretionary distributions from the trust.

Following an evidentiary hearing, the trial court found and concluded that: "[T]he [court] must take the extraordinary step of interfering with the trustee's discretion because it has been abused through actions improperly motivated by the self-interest of the trustee." Consequently, the court found that **McCart** was "owed" money from the trust for the years 1987 through 1990 and that, beginning in 1991, the trust must supplement McCart's income to the extent necessary to provide a standard of living comparable to that enjoyed by him during the years 1982 to 1985. The monetary value of this standard was fixed by the court.

Moreover, the court directed that, only if income attributable to McCart's wife exceeded this fixed amount would the spouse's income become relevant in calculating McCart's monthly distribution. Finally, the trial court ruled that Goss, individually and personally, should bear the attorney fees and costs incurred in the trial proceedings.

I.

McCart initially contends that Goss lacks standing to appeal the trial court's order because he, too, sought assistance from the court in interpreting the trust provisions, and thus, he was not an "aggrieved party."

It is undisputed, however, that Goss occupies two roles under the trust agreement: he is both trustee and remainderman. Inasmuch as the trial court's order substantially increased the distribution under the trust to the lifetime beneficiary, **McCart**, the order clearly impacts the size of the trust estate and, hence, Goss' remainder interest. Accordingly, Goss, unlike the executor in *Wilson v. Board of Regents,* 46 Colo. 100, 102 P. 1088 (1909), has an appealable interest in the court's order.

II.

Goss contends that the trial court erred in interfering with the exercise of his powers under the trust.

A.

First, Goss argues that the trial court erred in finding and concluding that he abused his discretion in making distributions under the trust. We disagree.

The crux of Goss' argument is that the trust agreement granted him "sole" and "absolute" discretion over distributions from the trust.

The record reveals that the trial court acknowledged Goss' authority under the trust. Nonetheless, the

trial court specifically found and concluded that Goss had abused his discretion and acted arbitrarily and capriciously. The trial court based this conclusion on explicit and detailed findings that Goss, in his capacity as trustee, had acted with improper motives and with a clear conflict of interest as trustee by seeking to conserve the trust funds for himself and his heirs as remaindermen under the trust and also in breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward the beneficiary, **McCart**.

The record further reveals that, as a basis for these findings, the trial court relied not only on statements attributable to Goss but also on Goss' actions. Specifically, the trial court cited Goss' "obvious"

anger that **McCart** had enjoyed the benefit of settlor's generosity during her lifetime and his "obvious" resentment over McCart's remarriage and his perception that, with his remarriage, **McCart** had other income and assets to provide for him while the trust was being conserved for Goss, his brother, and their descendants. The trial court also noted that Goss' undisputed diminishing and sporadic distributions to **McCart** beginning in 1987, the year following McCart's remarriage, were further evidence of Goss' improprieties, conflict of interest, and breach of fiduciary duties.

The trial court's findings clearly support a determination that Goss abused his discretion in the exercise of his powers as trustee under the trust. *See generally A. Scott, Trusts* § 187 (3d ed. 1967). The findings are, moreover, based on evidence in the record and, thus, will not be disturbed on appeal. *Page v. Clark,* 197 Colo. 306, 592 P.2d 792 (1979).

B.

Next, Goss argues that the trial court erred in determining both what money was "owed" by the trust to **McCart** and how much the trust should currently and in the future "pay" **McCart**. Goss' argument, in essence, is that past, present, and future payments should be contingent on McCart's reasonable "expenses."

The trial court rejected this argument, however, on the basis that not only was such an arrangement unworkable, the trust agreement contained no language requiring this consideration.

Indeed, the clear language of the trust is that the trust "provide [**McCart**] with a standard of living [to which] he is *accustomed....*" (emphasis added)

We conclude, as did the trial court, that no inference arises from this language that the trustee has been vested with discretion to control and dictate McCart's standard of living. Rather, the language directs the trustee to maintain, not ascertain, a standard of living calculated upon a *non-variable* factor, settlor's and McCart's years together.

The record reveals that the trial court had extensive financial information to arrive at this factor and thereby to determine the proper formula for disbursements. This information included a catalog of settlor's and McCart's expenditures and income for the years 1982 through 1985 which the court averaged to arrive at expenses of approximately $4668 per month.

Attributing half to **McCart**, the court arrived at a specific fixed figure for future distributions of $2334 per month. The record further reveals that the trial court averaged expenditures incurred by

McCart and his wife's expenses and income in order to determine that the current spouse's income was not, as yet, a factor in McCart's monthly distribution. Finally, taking into consideration that McCart had depleted his assets by engaging in capital gains transactions in order to meet his expenses and that Goss had previously agreed and was willing to pay a sum of $2000 per month for the 16 months prior to January 1987, the trial court concluded that the trust "owed" McCart an amount equivalent to $2000 per month for 1988, 1989, and 1990.

Having found an abuse in Goss' exercise of his discretion under the trust, the trial court was warranted in exercising its discretion to fashion a remedy both to repair past abuse and to control the future exercise of Goss' discretion under the trust. *See generally Stallard v. Johnson,* 189 Okl. 376, 116 P.2d 965 (1941); *Gulf National Bank v. Sturtevant,* 511 So.2d 936 (Miss.1987).

Inasmuch as the remedy here is consistent with the provisions of the trust and is supported by evidence introduced at trial, we perceive no error in the trial court's determination regarding either payments "owed" or payments "to be paid" from the trust.

III.

Next, we reject as without merit Goss' contention that the trial court erred in ordering

him to bear the attorney fees and costs, personally and individually.

A trustee is entitled to indemnity only for expenses incurred for the benefit of the trust estate *if the litigation is not the result of his own fault. A. Scott, supra,* § 244.

Here, the trial court specifically found and concluded that Goss had acted arbitrarily, capriciously, and in his own self-interest in violation of his fiduciary duties. Consequently, under the foregoing principle, Goss was clearly not entitled to the indemnity he requests.

The judgment is affirmed.

CRISWELL and ROTHENBERG, JJ., concur.

84 P.2d 820; NEWELL v. TUBBS; 103 Colo. 224

NEWELL v. TUBBS et al.

No. 14418.

Supreme Court of Colorado.

November 21, 1938.

As Modified Jan. 28, 1939.

In Department.

Error to District Court, City and County of Denver; Henry S. Lindsley, Judge.

Action by Samuel V. **Newell** against A. Farfield **Tubbs** and Martyn Schwartz, administrator of the estate of Max Schwartz, deceased, to annul an assignment by plaintiff to defendants of plaintiff's interest under a trust. To review an adverse judgment, plaintiff brings error and seeks a supersedeas.

Affirmed.

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Lewis D. Mowry and John L. Kivlan, both of Denver, for plaintiff in error.

David Rosner, of Denver, for defendants in error.

BAKKE, Justice.

This proceeding involves the construction of a trust provision contained in a will and the validity of the assignment of the interest of a beneficiary thereunder. The income from the trust estate was, under the terms of the will, to be used for the education of the great-grandchildren of the testator, the principal ultimately to be divided among the beneficiaries. The following compendious statement will sufficiently present the pertinent facts.

It appears from the pleadings that Henry Bolthoff died testate December 19, 1925, leaving a will in which it was provided by the seventh paragraph thereof that: "All the rest residue and remainder of my estate shall be converted into cash and invested in income producing securities approved by law for savings banks and for investment of the funds of estates, the said income to be proportionately used for the education of my great-grandchildren, the principal to be divided among said great-grandchildren, share and share alike, when the youngest great-grandchild, now living, shall have attained the age of twenty-one years." Plaintiff in error, **Newell**, who was plaintiff below, being a great-grandson of the testator, was one of the beneficiaries under this trust. February 7, 1934, for a valuable consideration, he executed a written assignment of his interest in the trust estate to **Tubbs** and Schwartz. **Tubbs**, with Schwartz' administrator, being the defendants in this action. July 13, 1934, by a formal document duly acknowledged before a notary public, **Newell** and his wife executed and delivered to **Tubbs** and

Schwartz a further formal release in which it was stated, among other things, that: "We, and each of us, further do expressly recite and acknowledge that our said attorney has fully and carefully explained to us all of our rights and liabilities in any way connected, arising out of, or collateral to each and all of the transactions and dealings above mentioned, and we know exactly what we are doing and what is involved."

Newell in his complaint asked for a decree annulling and cancelling the assignment and for an accounting. Defendants answered setting up the assignment and release. A demurrer to this answer being overruled, plaintiff elected to stand and judgment of dismissal was entered against him. Thereupon plaintiff sued out a writ of error to review the judgment, asking that the same operate as a supersedeas. We deem it to be for the best interests of

all concerned that the matter be finally determined upon the supersedeas application.

No question of legal disability, fraud or compulsion is presented. The complaint identifies the parties, sets out the will of Bolthoff as Exhibit A, and alleges that paragraph 7 thereof, above set out, is a positive and unqualified restraint on alienation and creates a spendthrift trust.

The only question presented is whether that paragraph creates such a trust. If it does, Newell's assignment of his interest is invalid and such a holding necessarily would result in a reversal of the judgment.

Upon careful consideration of the language used we are of the opinion that no such trust was created. Without setting out any formal definition, we may with propriety state that it is only by the use of language similar in meaning and legal import to that contained in the document under consideration in the recent case of Snyder v. O'Connor, 102 Colo. 567, 81 P. 2d 773, that such a trust may be established, and a few general observations on the law here applicable we think will sufficiently present our views on the subject.

A spendthrift trust is "a trust created to provide a fund for the maintenance of the beneficiary, and at the same time to secure it against his improvidence or incapacity." 65 C.J. 230. Clear and unequivocal language is necessary to create such a trust or, in the absence of such language, the intention to create must clearly appear from the language of the entire instrument. 65 C.J. 265. In the document under consideration in the instant case we find none of these requisites.

No reason is here presented which in equity requires the annulment of the assignment involved. There is no allegation which even intimates that any of the greatgrandchildren of the testator failed of education because of lack of financial aid from the fund established for that purpose and it is conceded that the youngest of the beneficiaries now is of age and that the trust fund may be distributed as directed.

Presented objections relating to defendants' pleadings are without merit.

Judgment affirmed.

BURKE, C. J., and HILLIARD and HOLLAND, JJ., concur.

81 P.2d 773; SNYDER v. O'CONNER.; 102 Colo. 567.

SNYDER et al. v. O'CONNER.

No. 14272.

Supreme Court of Colorado.

July 11, 1938.

In Department.

Error to District Court, City and County of Denver; George F. Dunklee, Judge.

Action by Mrs. Lila **O'Conner** against Irving **Snyder** and others, as executors and trustees of the estate of Henry **Snyder**, deceased, and another, to subrogate the plaintiff to the rights of Max **Snyder** as a testamentary beneficiary. Judgment for plaintiff, and defendants bring error.

Reversed, with directions.

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Ira. L. Quiat, Ralph J. Cummings, Benjamin C. Hilliard, Jr., and George A. Trout, all of Denver, for plaintiffs in error.

J. W. Kelley, of Denver, for defendant in error.

BOUCK, Justice.

There comes before us for review a final order of the Denver district court, by which, in an action brought for the purpose, it undertook to subrogate the defendant in error, Mrs. Lila **O'Conner**, to the rights of the plaintiff in error Max **Snyder** as a testamentary beneficiary, and to prescribe the future action of the Denver county court and the future action of the plaintiffs in error Irving **Snyder** and Max **Snyder** (as two of the three executors and trustees under the will of their father, Henry **Snyder**) as well as the future action of the plaintiff in error Cline, the third executor and trustee, all in connection with the administration of an estate in said county court.

Mrs. **O'Conner** is the owner of an unsatisfied judgment for about $2,600 against Max **Snyder**.

The district court ordered the county court, which under our law has plenary original jurisdiction over the administration of the Henry **Snyder** estate, and over the executors of the Henry **Snyder** will, to apply the proceeds of Max Snyder's interest in the estate on this judgment.

By his will the testator provided among other things that all but $1,000 of the residue of his property should be held in trust by his executors in "Fund B" and that the income therefrom should be paid semi-

annually to his five children, Morris, Max, Irving, Rose and Annie, equally. In case any of the five children die, that child's share of the income was to be paid to his or her issue equally, and if no issue survived the share was to be added to the shares of the surviving children. Max, who was a minor, was to receive his income upon attaining his majority. The principal of "Fund B" was to be distributed ten years after the testator's death among the surviving children, the share of any who had died to go to his or her issue equally, and if any should leave no issue his or her share was to be added to the shares of the surviving children.

The testator died May 11, 1932.

The will contained the following provision: "During the continuation of this trust, no beneficiary of the trust estate shall have the right to anticipate, sell, assign, mortgage, pledge, or otherwise dispose of or encumber his or her share of the trust estate, or any part thereof, or any interest therein; or his or her share of the income arising therefrom, or any part thereof, or any interest therein; nor shall such share of the trust estate or of the income arising therefrom be liable for his or her debts or be subject to attachment, garnishment, execution, creditor's bill or other legal or equitable process."

The passage just quoted is a legal provision in the nature of a spendthrift trust. We know of no reason why it should not be enforced in Colorado according to the intention of the testator, whose plain purpose was to insure the receipt of a periodical income by the beneficiaries during the ten years following his death, excluding the beneficiaries' creditors, and to let the survivors thereafter share the corpus equally. The testator could lawfully have willed his property away from his children entirely, and he had a right to limit his gift in the way he did. The income therefore could not be impounded during the ten-year period, and eventually the principal would vest only in the survivors. When the corpus of the trust is eventually distributed in 1942, the property will of course become as any other property, subject to all appropriate remedies of creditors at that time.

The idea of permitting the district court to interfere in an independent action, as it attempted here to interfere, with the administration of an estate is repugnant to the notion of fundamental judicial regularity. Until the county court orders the trust fund distributed, the property is in real a sense in custodia legis. Moreover, it is wholly uncertain whether in 1942 Max Snyder will be among the then surviving beneficiaries who are to share in the corpus of the trust. We cannot allow the district court to create, by a sort of judicial prophecy, what amounts to an anticipated lien that may never exist. The creditor of a testamentary beneficiary whose interest is so thoroughly contingent as Max Snyder's in the case at bar cannot thus project into a distant future a claim which such creditor may by reasonable diligence assert in a recognized proceeding

when and if uncertainty becomes certainty as the designated period is about to end. The county court would otherwise become a clearing house for collections, and creditors would turn the county court into a public collecting agency. It is our conviction that we ought not to transfer the burden of vigilance from creditor to court. The order of the district court must be reversed, with directions to vacate the same and dismiss the action.

Judgment reversed with directions.

BURKE, C. J., and YOUNG and KNOUS, JJ., concur.

827 P.2d 561; UNIV. NAT'L BANK V. RHOADARMER;

UNIVERSITY NATIONAL BANK, A Colorado Banking Corporation, Plaintiff-Appellee, v. Allen L. **RHOADARMER**, Kenneth G. Schoot, and Virginia Harsh, d/b/a Three Star Investments, Defendants, and Concerning Garnishee, J. Kenneth Harsh Trust, Dee Ann Standiferd, Trustee, Appellant.

No. 90CA1468.

Colorado Court of Appeals, Div. V.

August 29, 1991.

Rehearing Denied Oct. 3, 1991.

Certiorari Denied March 23, 1992.

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Stuart W. Olive, Schure, Olive and Gavaldon, Fort Collins, for plaintiff-appellee.

No appearance for defendants.

Arthur P. Roy, Greeley, for appellant.

Opinion by Judge NEY.

Garnishee, J. Kenneth Harsh Trust, appeals a judgment entered by the trial court in favor of plaintiff, University National Bank. We reverse.

The Bank, as judgment creditor of Virginia Harsh, sought to reach, by a writ of garnishment, her beneficial interest in the Trust. Relying on *In re Estate of Colman,* 35 Colo.App. 390, 535 P.2d 227 (1975), *aff'd,* 191 Colo. 242, 552 P.2d 1 (1976), the trial court concluded that the Bank was entitled to an award based on Virginia Harsh's non-cumulative right to withdraw annually from the Trust corpus, upon written request, up to $5,000 or 5% of the current market value. Because the Bank's garnishment was served in 1989 and hearing on the traverse was held in 1990, an award of $10,000, the amount equal to the value of two years of Virginia Harsh's rights, was made.

The trial court further concluded that the spendthrift clause in the Trust did not prohibit this invasion of principal.

I.

The Trust first contends that the trial court erred in treating the unexercised right to withdraw, a general power of appointment, as a property right subject to garnishment. We agree.

Section 13--54.5--103(2), C.R.S. (1987 Repl. Vol. 6A) sets forth property or earnings subject to garnishment:

"Any indebtedness, intangible personal property, or tangible personal property capable of manual delivery, other than earnings, owned by the judgment debtor. . . ."

We agree with the Trust's characterization of Virginia Harsh's right to the annual discretionary disbursement of funds from principal as a power of appointment. A power of appointment is a power of disposition created by an instrument which directs how the donee of that power is to exercise the disposition. The power here is similar to the power characterized by this court as a power of appointment in *In re Estate of Colman, supra.*

Further, we agree with the Trust's contention that a power of appointment is neither property nor a property right. Rather, it is a mere right or power, a personal privilege or authority. *Krausse v. Barton,*

430 S.W.2d 44 (Tex.Civ.App.1968); *Windscheffel v. Wright,* 187 Kan. 678, 360 P.2d 178 (1961).

We do not find dispositive on this issue, as the Bank contends, the holding in *In re Estate of Colman, supra,* that an unqualified right to receive $5,000 upon request was a presently taxable event for purposes of inheritance tax. This holding, based upon the Inheritances and Successions Tax Law, § 39--23--101, et seq., C.R.S. (1982 Repl.Vol. 16B) which ceased to apply to estates of decedents dying after January 1, 1980, as did the settlor here, is not equivalent to concluding that a general power of appointment is property. *See also People v. Cooke,* 150 Colo. 52, 370 P.2d 896 (1962) (for purpose of estate and inheritance taxation, power to dispose of property equivalent to ownership).

Consequently, we conclude that because a power of appointment is not property or a property right, such power is not a garnishable asset under § 13--54.5--103(2).

However, we are not convinced that the trial court ordered garnishment of the power of appointment as contended by the Trust. The trial court ordered surrender of the property which was subject to Virginia Harsh's power, *i.e.,* the sum of money which she had a right to request. Such money, if it is indeed the property of Virginia Harsh, is clearly subject to garnishment. *See* § 13--54.5--103(2). Therefore, we must consider whether the funds to which she was entitled upon written request, but for which no such request had been made, are in fact her property, merely held by the trust.

When a donor gives to another the power of appointment over property, the donee of the power does not thereby become the owner of the property. *Shattuck v. Burrage,* 229 Mass. 448, 118 N.E. 889 (1918). Rather, the appointee of the power, in its exercise, acts as a "mere conduit or agent for the donor." *Holzbach v. United Virginia Bank,* 216 Va. 482, 219 S.E.2d 868 (1975). The appointee, having received from the owner of the property instruction as to how the power may be utilized, possesses nothing but the authority to do an act which the owner might lawfully perform.

Thus, title to property over which the appointee has power remains in the donor until altered by the exercise of the power within any limitations set out by the donor. Here, Virginia Harsh could have exercised her power of appointment, by written request, to alter title to the subject funds, thereby removing them from the Trust and vesting title in herself. She did not do so, and the power retains the character of an offer which has not been accepted. And, "[u]ntil accepted, the person to whom the offer is made has not, nor can he have, the slightest interest in, or title to, the property." *Gilman v. Bell,* 99 Ill. 144 (1881).

Hence, we conclude that until Virginia Harsh properly exercises her power of appointment, the

trustee retains absolute control and benefit of the Trust corpus within the terms of the trust instrument. Accordingly, Virginia Harsh, absent exercise of the power granted to her, has no property held by the Trust susceptible to garnishment.

II.

The Trust further contends that the trial court erred in its conclusion that the spendthrift provision of the Trust failed to prevent garnishment by creditors. We again agree.

The Trust instrument provides:

> "The interest of the beneficiaries shall not be subject to assignment, alienation, pledge, attachment, or the claims of their creditors. This provision shall not prevent the exercise of, or transfer pursuant to the exercise of, any right of disclaimer or power of appointment granted in this agreement or under any rule of law."

The validity and enforceability of spendthrift provisions in this state is not disputed. And, the Bank is correct in its assertion that the intent of the settlor at the time the clause was drafted will govern just what is protected by a spendthrift clause. *Meier v. Denver U.S. National Bank,* 164 Colo. 25, 431 P.2d 1019 (1967).

The Bank maintains that, although the provision manifests an intent to exclude claims by creditors of the beneficiaries, it clearly excepts any benefit to be received pursuant to the exercise of a power of appointment. Again, the Bank is correct. However, the exception noted by the Bank is conditioned upon the *exercise* of the power of appointment. Here, it is undisputed that Virginia Harsh, the holder of the power, did not, by written request as required, exercise her power to appoint a portion of the trust corpus to herself or to anyone else.

The Bank relies upon *Brent v. State of Maryland Central Collection Unit,* 311 Md. 626, 537 A.2d 227 (1988) and *First National Bank v. First Cadco Corp.,* 189 Neb. 734, 205 N.W.2d 115 (1973) for the proposition that once a beneficiary has the right to income or principal, that income or principal belongs to the beneficiary and is reachable by creditors. Therefore, it asserts that the fact that Virginia Harsh had not exercised her power to receive funds was immaterial.

We do not agree. Rather, we rely upon the more fundamental common law principle that property subject to a donee's general power of appointment is available to his creditors only if the power is exercised. G. Bogert, *Trusts & Trustees* § 233 (rev. 2d ed. 1977); Annot, 18 A.L.R. 1470 (1922). Further, the donee of such a power may not be compelled to exercise it, nor may his creditors acquire the power. IIA A. Scott, *Trusts* § 147.3 (4th ed. 1987).

We find persuasive the similar case of *Snyder v. O'Conner,* 102 Colo. 567, 81 P.2d 773 (1938). There, the supreme court found the order of the district court to award trust assets to a judgment creditor in spite of a spendthrift provision to be an interference in an independent action and "repugnant to the notion of fundamental judicial regularity." Such action would, the court felt, result in the probate court becoming a "clearing house for collections" and would turn that court into a "public collection agency."

Accordingly, because Virginia Harsh has not exercised her power of appointment and because the trial court may not, in effect, exercise it in her stead, she possesses no garnishable interest in assets

which remain the property of the Trust. Further, the spendthrift provision here prevents invasion of Trust property for the benefit of her creditors.

The judgment is reversed.

PLANK and JONES, JJ., concur.

Newman Article

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SPENDTHRIFT AND DISCRETIONARY TRUSTS: ALIVE AND WELL UNDER THE UNIFORM TRUST CODE

Alan Newman*

Editors' Synopsis: This Article explains how the creditors' rights provisions in the Uniform Trust Code ("UTC") treat issues surrounding spendthrift and discretionary trusts. The Article asserts that criticism directed toward the UTC's creditors' rights provisions is unwarranted, particularly in light of recent amendments to those provisions that clarify that the UTC will continue to allow the protections traditionally afforded by spendthrift and discretionary trusts.

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I. INTRODUCTION

Among the provisions of the Uniform Trust Code ("UTC" or the "Code") that have attracted the most attention are those of Article 5: Creditor's Claims; Spendthrift and Discretionary Trusts.[1] Although much of the UTC is a codification of the common law of trusts,[2] there are many differences among the states in their handling of various creditors' rights issues,[3] and many jurisdictions have no law on some of those issues.[4] As a result, there is no well-accepted, established common law on some of the issues addressed by Article 5. Further, while the UTC's approach to many creditors' rights issues is consistent with the common law in many states, in other respects the UTC's approach is innovative and differs from

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[1] *See, e.g.*, Mark Merric & Steven J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?*, 31 EST. PLAN. 478 (Oct. 2004). For an overview of the development of the UTC and its enactments through the fall of 2005, and an analysis of criticisms of its creditors' rights provisions, see Robert T. Danforth, *Article Five of the UTC and the Future of Creditors' Rights in Trusts*, 27 CARDOZO L. REV. (forthcoming March 2006).

[2] *See* UNIF. TRUST CODE prefatory note (amended 2005), 7C U.L.A. 178 (Supp. 2005). The "common law of trusts" is, of course, difficult to pin down, particularly in recent years. As noted by Professor Halbach, during the latter part of the twentieth century, particularly during the 1990s, trust law "experienced a period of rigorous, comprehensive reexamination." Edward C. Halbach, Jr., *Uniform Acts, Restatements, and Trends in American Trust Law at Century's End*, 88 CAL. L. REV. 1877, 1881 (2000).

[3] See, for example, 2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 152.1, at 98-105 (4th ed. 1987) for a discussion of the different treatment states afford spendthrift provisions.

[4] Professor Scott's treatise notes, for example, "There is little authority on the question whether the interest of the beneficiary of a spendthrift trust can be reached by persons against whom he has committed a tort." *Id.* at § 157.5. For two recent cases that denied tort claimants access to criminal tortfeasors' interests in spendthrift trusts, *see* Duvall v. McGee, 826 A.2d 416 (Md. 2003); Scheffel v. Krueger, 782 A.2d 410 (N.H. 2001).

existing law in many states.[5] In some ways, Article 5 enhances the asset protection planning traditionally afforded by trusts,[6] while in others, at least with respect to the right of a child, spouse, or former spouse of a beneficiary of a discretionary trust to compel distributions he or she can reach, it enhances creditors' rights.[7]

This Article addresses spendthrift and discretionary trust issues under the UTC in a question and answer format that is intended to respond to concerns, issues, and claims that have been raised or made about the UTC's creditors' rights provisions. As the Article demonstrates, much of the criticism the UTC has received over this subject is unwarranted. Some of the criticism, however, has been instrumental in recent revisions to creditors' rights provisions of the Code and its comments.[8] While those revisions may not have satisfied all of the concerns of the UTC's critics, the revisions clarify that the Code will not have the adverse effects on protections trusts have traditionally provided that the Code's critics predict.

II. SPENDTHRIFT: PROTECTION AND EXCEPTIONS

Sections 502 and 503 of the UTC address spendthrift provisions and the exceptions to the protection they provide. They are the best places to start to understand the UTC's creditors' rights provisions.

A. What Is the Effect of a Valid Spendthrift Provision?

Under UTC section 502(c), if the terms of the trust include a valid spendthrift provision, "except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary."[9] Thus, as a general rule, most creditors of a beneficiary of a spendthrift trust may not reach the beneficiary's interest or the assets of the trust. Rather the creditor must wait for a distribution to be made to the beneficiary, and then pursue a claim against the beneficiary individually.

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[5] For example, the UTC does not classify trusts as "discretionary trusts" or "support trusts" for creditors' rights purposes. *See infra* Section VI.

[6] For example, under the UTC, generally creditors of a beneficiary of a discretionary trust may not compel distributions they can reach even if they have provided support to the beneficiary and the trust is for the beneficiary's support. *See infra* Section VI.

[7] *See infra* notes 111-18 and accompanying text.

[8] *See infra* notes 354-62 and accompanying text.

[9] UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 250 (Supp. 2005) (alteration in original).

1. May the Trustee Make Protected Distributions From a Spendthrift Trust To Third Parties For the Beneficiary's Benefit?

The UTC does not explicitly address this question. Presumably, however, the answer is "yes." Trust instruments commonly authorize the trustee to make distributions to third parties for the benefit of the beneficiary, as well as directly to the beneficiary.[10] Section 502(c) prohibits a beneficiary's creditor from reaching a distribution "before its receipt by the beneficiary."[11] Because a distribution for the benefit of a beneficiary that is made to a third party would never be received by the beneficiary, the beneficiary's creditor presumably would be unable to reach it. Thus, it appears that distributions from a spendthrift trust in the form of payments to certain creditors of the beneficiary (for example, a credit card company or the lessor of an automobile to the beneficiary) would not be reachable by most creditors of the beneficiary.[12] Finally, while section 501 provides that a beneficiary's creditors may attach distributions "to or for the benefit of the beneficiary," it explicitly applies only "[t]o the extent a beneficiary's interest is not subject to a spendthrift provision."[13]

Protected indirect distributions for the benefit of a spendthrift trust beneficiary likely will also be allowed even if the instrument does not expressly authorize the trustee to make them. Presumably the beneficiary would have acquiesced in the indirect distributions,[14] and most creditors of a beneficiary of a spendthrift trust have no claim against the trustee, the trust assets, or the beneficiary's interest in the trust. The Restatement (Third) of Trusts contemplates that these distributions may be made by the trustee, although not in the context of creditor avoidance.[15] Note, however,

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[10] These provisions effectively define, in part, the beneficiary's interest in the trust. According to the Third Restatement, in determining the extent of the interest of a trust beneficiary, "The terms of the trust . . . will be respected and given effect unless contrary to public policy." RESTATEMENT (THIRD) OF TRUSTS § 49 cmt. a (2003).

[11] UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005).

[12] Note that UTC section 503(c) contemplates distributions for the benefit of the beneficiary, instead of directly to the beneficiary, by providing that the claim of a spendthrift exception creditor may reach distributions "to or for the benefit of the beneficiary." *Id.* § 503(c), at 253.

[13] *Id.* § 501, at 250.

[14] *See id.* § 1009, at 326 (protecting the trustee from liability for conduct that otherwise would constitute a breach when there is a consent, release, or ratification by the beneficiary of the trustee's conduct).

[15] *See* RESTATEMENT (THIRD) OF TRUSTS § 49 cmt. c(2) (2003) ("A trustee who improperly applies or distributes income in good faith for the support, care, or other needs of the beneficiary (whether or not under a legal disability) is entitled to credit in the trust

that the UTC's explicit authorization of a trustee to make distributions for the benefit of a beneficiary, instead of directly to the beneficiary, applies only for incapacitated beneficiaries.[16]

2. *Are There Limits On the Size of a Trust That May Be Protected By a Spendthrift Provision, or On the Amount of Distributions That May Be Made To or For the Benefit of a Beneficiary of a Spendthrift Trust?*

No. Unlike the law in some states, the UTC does not limit the amount of protected distributions that may be made from a spendthrift trust to or for the benefit of its beneficiary to, for example, amounts necessary to provide for the beneficiary's support.[17] Further, spendthrift protection is not limited by the size of the trust[18] or to a fixed amount of annual income.[19]

B. What Constitutes a Valid Spendthrift Provision?

A spendthrift provision is valid under the UTC "only if it restrains both voluntary and involuntary transfer of a beneficiary's interest."[20] As a result, a settlor may not provide spendthrift protection from the beneficiary's creditors, while authorizing the beneficiary to transfer the beneficiary's interest voluntarily.[21] Thus, if the beneficiary may sell, encumber, or otherwise transfer the interest, the beneficiary's creditors may reach it.[22]

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accounts to the extent the beneficiary would otherwise be unjustly enriched.").

[16] *See* UNIF. TRUST CODE § 816(21) (amended 2005), 7C U.L.A. 312 (Supp. 2005).

[17] For a discussion of statutes so limiting the effect of spendthrift provisions in a number of states, see 2A SCOTT & FRATCHER, *supra* note 3, § 152.1.

[18] Prior to its amendment in 2001, Virginia's spendthrift statute limited its protection to $1,000,000 of trust assets. VA. CODE ANN. § 55-19 (2003 & Supp. 2005).

[19] *See, e.g.*, OKLA. STAT. ANN. tit. 60, § 175.25(B)(2) (West Supp. 2005) (protecting $25,000 per calendar year).

[20] UNIF. TRUST CODE § 502(a) (amended 2005), 7C U.L.A. 251 (Supp. 2005). The UTC does not address the question whether a trust provision allowing the beneficiary to voluntarily transfer the beneficiary's interest, but only with the consent of a third party, sufficiently restrains the transfer to make the spendthrift provision valid.

[21] In its enactment of the UTC, Missouri modified section 502(a) to validate a spendthrift provision that restrains either voluntary or involuntary transfers, or both. *See* MO. REV. STAT. § 456.5-502.1 (2005).

[22] Although the decision to bar the claim of a beneficiary's creditor from reaching the beneficiary's interest only if the beneficiary also is barred from voluntarily transferring it was policy based, the settlor effectively can give the beneficiary the power to assign the interest without jeopardizing spendthrift protection by giving the beneficiary a power of appointment. *See* David M. English, *The Uniform Trust Code (2000): Significant Provisions*

While spendthrift protection is available under the UTC only if there is a valid spendthrift provision,[23] it may not be necessary that the instrument itself include one. Under the Code, "spendthrift provision" is defined as a "term of a trust,"[24] and the "terms of a trust" are defined as "the manifestation of the settlor's intent regarding a trust's provisions as expressed in the trust instrument or as may be established by other evidence that would be admissible in a judicial proceeding."[25] No magic words are required to evidence the settlor's intent that the trust be spendthrift. Rather, for example, simply providing that the beneficiary's interest is held subject to a "spendthrift trust" is sufficient.[26]

C. What Creditors' Claims Are not Barred By a Spendthrift Provision?

Section 503 lists three creditors ("exception creditors") who may reach a beneficiary's interest in a spendthrift trust: (1) the beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, (2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, and (3) the state or the United States to the extent a statute of the state or federal law so provides.[27]

D. Is the Exception for Claims of a Child, Spouse, or Former Spouse Consistent With Common Law?

Yes.[28] As the comment to section 503 notes, this exception has been codified in many states and is consistent with federal bankruptcy law.[29] Of

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and Policy Issues, 67 MO. L. REV. 143, 181 (2002).

[23] *See* UNIF. TRUST CODE § 502 (amended 2005), 7C U.L.A. 251 (Supp. 2005).

[24] *Id.* § 103(16), at 192.

[25] *Id.* § 103(18). Extrinsic evidence, if admissible in a judicial proceeding, that may establish terms of a trust includes "[o]ral statements, the situation of the beneficiaries, the purposes of the trust, the circumstances under which the trust is to be administered, and, to the extent the settlor was otherwise silent, rules of construction. . . ." *Id.* § 103 cmt., at 196. Note that the UTC allows even unambiguous trust instruments, including wills creating testamentary trusts, to be reformed to correct mistakes of fact or law, whether of expression or inducement, if there is clear and convincing evidence of both the settlor's intent and the terms of the trust. *See id.* § 415, at 246.

[26] *See id.* § 502(b), at 251. If the express terms of the trust impose a restraint on either voluntary or involuntary transfers, but not both, the intent to restrain the other may be implied. *See* 2A SCOTT & FRATCHER, *supra* note 3, § 152.4, at 118.

[27] *See* UNIF. TRUST CODE § 503(b) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[28] *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 157(a) (1959).

[29] UNIF. TRUST CODE § 503 cmt. (amended 2005), 7C U.L.A. 253 (Supp. 2005). Note

the first twelve jurisdictions to enact the UTC,[30] however, eight have modified this exception or deleted it entirely.[31]

E. What Kind of Creditor Might Assert a Claim Against a Spendthrift Trust Under the Exception For the Claim of a Judgment Creditor Who Has Provided Services For the Protection of a Beneficiary's Interest in the Trust?

An attorney is one example. The comment to section 503 notes, "This exception allows a beneficiary of modest means to overcome an obstacle preventing the beneficiary's obtaining services essential to the protection or enforcement of the beneficiary's rights under the trust."[32]

1. Is This Exception Consistent with Common Law?

The exception is consistent with the Restatements.[33] Case law, however, is sparse and not definitive, so it is difficult to determine what the common law on this subject is.[34]

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also that the Employee Retirement Income Security Act requires qualified pension plans to subject a participant's benefits to a qualified domestic relations order. *See* 29 U.S.C. § 1056(d)(3) (2000).

[30] Arkansas (*see* 2005 Ark. Acts §§ 28-73-101 to 28-73-1105); the District of Columbia (*see* D.C. CODE ANN. §§ 19-1301 to 19-1311.03 (LexisNexis 2005)); Kansas (*see* KAN. STAT. ANN. §§ 58a-101 to 58a-1107 (Supp. 2004)); Maine (*see* ME. REV. STAT. ANN. tit. 18B, §§ 101-1104 (Supp. 2004); Missouri (*see* MO. ANN. STAT. §§ 456.1-101 to 456.11-1106 (West Supp. 2005)); Nebraska (*see* NEB. REV. STAT. ANN. §§ 30-3801 to 30-38,110 (Supp. 2004)); New Hampshire (*see* N.H. REV. STAT. ANN. §§ 564-B:1-101 to 564-B:11-1104 (Supp. 2004)); New Mexico (*see* N.M. STAT. ANN. §§ 46A-1-101 to 46A-11-1104 (LexisNexis 2004)); Tennessee (*see* TENN. CODE ANN. §§ 35-15-101 to 35-15-1103 (Supp. 2004)); Utah (*see* UTAH CODE ANN. §§ 75-7-101 to 75-7-1103 (Supp. 2005)); Virginia (*see* 2005 Va. Acts ch. 31, §§ 55-541.01 to 55-551.06); Wyoming (*see* WYO. STAT. ANN. §§ 4-10-101 to 4-10-1103 (2005)).

[31] Arkansas, Kansas, Maine, and Tennessee do not protect children or spouses. *See* 2005 Ark. Acts § 28-73-503; KAN. STAT. ANN. § 58a-503 (Supp. 2004); ME. REV. STAT. ANN. tit. 18B, § 503 (Supp. 2004); TENN. CODE ANN. § 35-15-503 (Supp. 2004). The District of Columbia, Virginia, and Wyoming protect children but not spouses. *See* D.C. CODE ANN. § 19-1305.03 (LexisNexis 2005); 2005 Va. Acts ch. 31, § 55-545.03.B; WYO. STAT. ANN. § 4-10-503 (2005). New Hampshire limits a spouse's protection by requiring that the judgment or court order for alimony "expressly specifies the alimony amount attributable to the most basic food, shelter and medical needs of the spouse or former spouse." N.H. REV. STAT. ANN. § 564-B:5-503(b)(2) (Supp. 2004).

[32] UNIF. TRUST CODE § 503 cmt. (amended 2005), 7C U.L.A. 254 (Supp. 2005).

[33] *See* RESTATEMENT (SECOND) OF TRUSTS § 157(c) (1959); RESTATEMENT (THIRD) OF TRUSTS § 59(b) (2003).

[34] *See* RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 59 cmts. c and d, at

2. Would This Exception Apply to Allow Another Exception Creditor of a Beneficiary (For Example, a Child Support or Alimony Claimant) Who Successfully Asserts a Claim Against the Beneficiary's Interest in a Spendthrift Trust to Recover His or Her Attorneys' Fees From the Beneficiary's Interest in the Trust?

It should not. By its terms, this exception is for "a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust."[35] An exception creditor of a beneficiary who reaches his or her interest in the trust would not have provided services for the protection of the beneficiary's beneficial interest in the trust. Similarly, if a beneficiary's former spouse is awarded attorneys' fees against the beneficiary, the claim to recover fees should not be recoverable against the beneficiary's interest in the trust under the exception related to services provided for the protection of the beneficiary's interest in the trust. Note, however, that under section 1004, "In a judicial proceeding involving the administration of a trust, the court, as justice and equity may require, may award costs and expenses, including reasonable attorney's fees, to any party, to be paid by another party or from the trust that is the subject of the controversy."[36]

F. Is the Exception for Claims of the State or the United States Consistent With the Common Law?

The exception is narrower than the exception for claims of the government under the Second Restatement. The UTC excepts from spendthrift protection claims of the state or the United States only to the extent another state statute or federal law so provides.[37] By contrast, the Second Restatement provides that a spendthrift provision will not protect the beneficiary's interest from a claim of a state or the United States without regard to whether another state statute or federal law so provides.[38]

404-05 (2003).

[35] UNIF. TRUST CODE § 503(b)(2) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[36] *Id.* § 1004, at 322. According to the comment to § 1004, the section "codifies the court's historic authority to award costs and fees, including reasonable attorney's fees, in judicial proceedings grounded in equity." *Id.* cmt.

[37] *See id.* § 503(b)(3), at 253.

[38] RESTATEMENT (SECOND) OF TRUSTS § 157(d) (1959).

G. Does the Exception for Claims of the State or the United States Allow the List of Exception Creditors to Be Expanded?

If existing or new federal law allows the United States to reach the interests of beneficiaries in spendthrift trusts (to satisfy a beneficiary's federal income tax obligations, for example), it will preempt a state's version of the UTC (or any other state law).[39] Further, a state always has the prerogative of enacting new legislation, including legislation enforcing a spendthrift provision against a claim of the state, regardless of whether it has enacted the UTC.

1. Why Does the UTC Include a Provision Making the State a Spendthrift Exception Creditor to the Extent Another Statute of the State So Provides?

According to Professor English, the UTC Reporter, this exception "leav[es] to other state law the extent to which a state can pierce a trust to collect for the costs of institutionalized care."[40] If an enacting state had this type of statute (or one that, for example, allowed it to reach spendthrift trusts to collect delinquent income taxes) and it enacted the UTC's spendthrift provisions without this exception, the newly enacted spendthrift provisions would be inconsistent with, and arguably would effectively repeal, the existing state statutes.

2. Why Does This Provision of the UTC Also Refer to Claims of the United States?

Perhaps simply for transparency purposes. As mentioned, under standard preemption doctrine, if federal law (whether existing at enactment or arising subsequent to enactment) allows the federal government to reach spendthrift trusts, it will not matter whether a state has or does not have a statute allowing claims of the United States.[41]

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[39] *See, e.g.*, First Nw. Trust Co. v. I.R.S., 622 F.2d 387, 390 (8th Cir. 1980); U.S. v. Riggs Nat'l Bank, 636 F. Supp. 172 (D.D.C. 1986); LaSalle Nat'l Bank v. U.S., 636 F. Supp. 874 (N.D. Ill. 1986).

[40] English, *supra* note 22, at 183.

[41] Thus, deleting the reference in UTC section 503(b)(3) to claims of the United States should have no substantive effect. For a section 503 enactment that includes an exception for claims of the state under other state statutes, but does not reference claims of the United States, see TENN. CODE ANN. § 35-15-503 (Supp. 2004).

H. Are Claims of Those Who Have Provided Necessities (For Example, Support) to the Beneficiary Barred By a Spendthrift Provision?

Yes. Unlike under the Restatements,[42] the UTC provides that a spendthrift provision will bar the claims of those who provided necessities to the beneficiary.[43] The most important consequence of the UTC's omission of this exception from section 503 is that a reimbursement claim of a public benefits provider against a trust of which the recipient is a beneficiary would be barred by a spendthrift provision. While a state's reimbursement claim for Medicaid benefits should be a part of its estate recovery program that will not arise until after the death of the beneficiary and the beneficiary's spouse,[44] reimbursement claims for other state provided public benefits will be barred by a spendthrift provision. The UTC does not include a necessities provider's spendthrift exception to avoid making law that would give the state a right to reimbursement from spendthrift trusts.[45] If, however, there is another state statute that gives the state the right, the UTC will not affect the state's right to reimbursement from the trust under that other statute.[46] Thus, the UTC drafters chose not to address this policy-oriented, public benefits issue one way or the other, leaving instead the issue to other state law.

I. Under the UTC, May a Tort Claimant Reach a Beneficiary's Interest in a Spendthrift Trust?

No. In another departure from the Restatements,[47] the UTC bars a tort claimant from reaching the interest of a beneficiary tortfeasor in a spendthrift trust, regardless of the nature of the beneficiary's conduct that gave rise to the tort claim. Under UTC section 502(c), creditors may not reach a beneficiary's interest in a spendthrift trust, "except as otherwise provided in this [article]."[48] There is no provision in Article 5 for a tort claimant

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[42] *See* RESTATEMENT (THIRD) OF TRUSTS § 59(b) (2003); RESTATEMENT (SECOND) OF TRUSTS § 157(b) (1959).

[43] *See* UNIF. TRUST CODE §§ 502-503 (amended 2005), 7C U.L.A. 251-53 (Supp. 2005).

[44] *See* 42 U.S.C. § 1396p(b)(1) (2000).

[45] *See* David M. English, *Is There a Uniform Trust Act in Your Future?*, PROB. & PROP., Jan.-Feb. 2000, at 25, 31.

[46] *See* UNIF. TRUST CODE § 503(b)(3) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[47] *See* RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a (2003); RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. a (1959).

[48] UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005) [alteration in original].

exception (or for the court to recognize additional spendthrift exceptions on policy grounds).[49] Rather, the list of spendthrift exceptions in section 503 is expressly made exclusive by section 502(c).[50]

J. What Rights Does the UTC Grant an Exception Creditor?

While the answer to this question under the UTC as initially promulgated was uncertain, the uncertainty has been removed by amendments made to the UTC and its comments in 2005. Section 503(c) now provides: "A claimant against which a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary."[51] While section 503(c) does not explicitly provide that attachment is the exclusive UTC provided remedy for

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[49] Further, the comment to section 503 specifically notes that the UTC drafters "declined to create an exception for tort claimants." *Id.* § 503 cmt., at 254. For a case with compelling facts in which the court nevertheless refused to create a public policy, tort claimant exception to similar statutory spendthrift protection, see Scheffel v. Krueger, 782 A.2d 410 (N.H. 2001).

[50] UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005).

[51] *Id.* § 503(c), at 253. Prior to its amendment in 2005, section 503 specified attachment as a remedy for two of the three spendthrift exception creditors (a child or spousal support claimant and a judgment creditor who had provided services for the protection of the beneficiary's interest in the trust). *See* UNIF. TRUST CODE § 503(b) (2004), 7C U.L.A. 253 (Supp. 2005) (amended 2005). The remedy for the state or the United States was not specified, perhaps on the assumption that the other state statute or federal law allowing the state or the United States to reach a spendthrift trust would provide a remedy. *See id.* § 503(c). Compounding the problem was an inconsistency between section 501 and its comment. Section 501, which allows creditors broader remedies than attachment, provided that it was applicable "[t]o the extent a beneficiary's interest is not protected by a spendthrift provision." *Id.* § 501, at 250. That language arguably made the section's broader remedies available not only to creditors of beneficiaries of trusts without spendthrift provisions, but also to exception creditors of trusts with spendthrift provisions. The comment to section 501, however, referred to it being applicable "[a]bsent a valid spendthrift provision." *Id.* § 501 cmt. The 2005 amendments resolve these uncertainties. First, the introductory clause of section 501 has been revised to read: "To the extent a beneficiary's interest is not *subject to* a spendthrift provision . . . ." UNIFORM TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005) (emphasis added). Second, the comment to section 501 also was amended in 2005. It now provides, in part:

> This section applies only if the trust does not contain a spendthrift provision or the spendthrift provision does not apply to a particular beneficiary's interest. A settlor may subject to spendthrift protection the interests of certain beneficiaries but not others. A settlor may also subject only a portion of the trust to spendthrift protection such as an interest in the income but not principal.

Id. § 501 cmt.

spendthrift exception creditors, its comment does.[52]

1. Would an Exception Creditor Be Able to Attach Discretionary As Well As Mandatory Distributions?

Presumably, yes.[53] Section 503(c) allows attachment of present or future distributions without reference to distributions being mandatory or discretionary.[54] Furthermore, in the context of a claim by a beneficiary's child, spouse, or former spouse with a judgment or court order for support, the comment to section 503 specifically provides that the child or spouse may reach discretionary distributions.[55]

2. Is Allowing an Exception Creditor to Attach Discretionary Distributions a Change in the Common Law?

The law is not well settled on the question whether a creditor of a beneficiary of a discretionary trust may attach future discretionary distributions. This subject is discussed in Section III.D.2 below.

3. What Are the Rights of the United States Against the Beneficiary of a Discretionary Trust Who has Unpaid Federal Income Tax Liabilities?

First, as previously noted, a spendthrift provision would be ineffective against this type of claim, regardless of the terms of the UTC or other state law.[56] If the terms of the trust gave the trustee the discretion to make distributions for the beneficiary's support, the federal tax lien would attach to the beneficiary's interest in the trust.[57] If the trust instrument did not include a support standard and gave the trustee broad discretion in distributions, the federal tax lien would not attach to the beneficiary's interest in the trust,[58] but the United States would be able to attach future distribu-

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[52] *See id.* § 503 cmt., at 254. Note, however, that other creditor law of a jurisdiction may provide an exception creditor with additional remedies. *Id.*

[53] Note, though, that allowing a creditor to attach discretionary distributions the trustee chooses to make does not mean the creditor can compel discretionary distributions it can reach. *See infra* Section IV.

[54] *See* UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[55] *See id.* § 503 cmt., at 253-54.

[56] *See supra* note 39 and accompanying text.

[57] *See* Magavern v. United States, 550 F.2d 797 (2d Cir. 1977), *aff'g* 415 F. Supp. 217 (W.D.N.Y. 1976). *See also* I.R.S. Chief Couns. Adv. 200036045 (May 16, 2000).

[58] *See* I.R.S. Chief Couns. Adv. 200036045 (May 16, 2000). *See also* United States v. O'Shaughnessy, 517 N.W.2d 574, 578 (Minn. 1994) (holding that a beneficiary's interest in a purely discretionary trust is not "property" or "any right to property," within the mean-

tions the trustee decided to make in the exercise of its discretion.[59]

4. If an Exception Creditor Attaches Distributions That Otherwise Would Be Made to the Beneficiary, Would the Beneficiary Be Able to Benefit from the Trust Before the Creditor Was Paid in Full?

Perhaps. Section 503(c), as amended in 2005, authorizes the court to "limit the [creditor's] award to such relief as is appropriate under the circumstances."[60] Presumably, this authority would allow the court to consider the beneficiary's needs, as well as the claim of the exception creditor.[61]

K. May a Trustee Withhold Distributions From a Beneficiary of a Spendthrift Trust to Prevent the Beneficiary's Creditor From Reaching Them in the Hands of the Beneficiary?

A trustee could withhold discretionary distributions.[62] As previously discussed,[63] distributions presumably may be made from spendthrift trusts to third parties for the beneficiary's benefit to prevent creditors from reaching them. If, however, a "mandatory distribution of income or principal, including a distribution upon termination of the trust," is not made "to the beneficiary within a reasonable time after the designated distribution date," the creditor may reach it.[64]

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ing of the federal tax lien statute, before the trustee has exercised its discretionary power of distribution under the trust agreement).

[59] *See* U.S. v. Cohn, 855 F. Supp. 572 (D. Conn. 1994). *See also* Richard W. Nenno, *Delaware Dynasty Trusts, Total Return Trusts, and Asset Protection Trusts, in* ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS (Duncan E. Osborne and Elizabeth Morgan Schurig eds. 1995).

[60] UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[61] Section 501, which addresses trusts the terms of which do not include spendthrift provisions, similarly allows the court to limit a creditor's award as appropriate under the circumstances. *Id.* § 501, at 250. Prior to its amendment in 2005, the comment to section 501 provided that the court could consider the "support needs" of a beneficiary and the beneficiary's family. UNIF. TRUST CODE § 501 cmt. (2004), 7C U.L.A. 251 (Supp. 2005) (amended 2005). Because of concerns of the potential effect of that language on a beneficiary of a supplemental needs trust who was receiving public benefits, it was amended in 2005 to refer not to the "support needs" of the beneficiary and the beneficiary's family, but to their "circumstances." UNIF. TRUST CODE § 501 cmt. (amended 2005), 7C U.L.A. 251 (Supp. 2005). *See infra* note 81.

[62] *See infra* Section IV (discussing the inability of most creditors of a beneficiary to compel discretionary distributions).

[63] *See supra* notes 10-16 and accompanying text.

[64] UNIF. TRUST CODE § 506(b) (amended 2005), 7C U.L.A. 261 (Supp. 2005). Pre-

1. What is a "Mandatory Distribution"?

As originally promulgated, the UTC did not define "mandatory distribution."[65] The comment to section 506 referred to them as distributions that are "required to be made by the express terms of the trust."[66] Thus, if the terms of a trust require current distributions of all income, or a unitrust amount, or all or part of the principal at specified times, those amounts clearly would constitute mandatory distributions. In light of section 504(b), which prohibits most creditors from compelling discretionary distributions without regard to whether the trust terms include a support or other standard,[67] "mandatory distributions" arguably should not have been construed to include distributions subject to the trustee's discretion, regardless of whether one or more standards (for example, support) were provided to guide the trustee in the exercise of its discretion.

Section 504(b), however, by its express terms applies to "a distribution that is subject to the trustee's discretion."[68] As a result, terms of a trust that do not expressly grant the trustee discretion and that mandate distributions pursuant to a support standard (for example, "the trustee shall make distributions of income and principal to provide for the beneficiary's support"), arguably could be construed as describing "mandatory distributions" within the meaning of section 506 that are not covered by section 504(b). Section 504, however, "eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. . . . By eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both."[69] Thus, that argument should be unsuccessful, section 504(b) should apply to trusts that require distributions for the beneficiary's support, and the distributions should not be "mandatory distributions" within the meaning of section 506, as originally promulgated.

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sumably a mandatory distribution made for the benefit of a beneficiary within the requisite reasonable time would preclude a creditor of a beneficiary from reaching the distribution under section 506. *See supra* notes 10-16 and accompanying text. To avoid any question in that regard, section 506 could be amended to instead refer to distributions made "to or for the benefit of the beneficiary."

[65] *See* UNIF. TRUST CODE § 103 (2004), 7C U.L.A. 191-92 (Supp. 2005) (amended 2005); *id.* § 506, at 261.

[66] *Id.* § 506 cmt., at 261.

[67] *See infra* Section IV (discussing § 504(b)).

[68] UNIF. TRUST CODE § 504(b) (amended 2005), 7C U.L.A. 256 (Supp. 2005).

[69] *Id.* § 504 cmt.

Because of concerns that were expressed in that regard, however, section 506 was amended in 2005 to include a definition of "mandatory distribution."[70] Under the 2005 amendment, a mandatory distribution is:

> a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.[71]

2. *What is a "Reasonable Time" for the Trustee to Make a Mandatory Distribution?*

The UTC does not address this question.[72]

3. *May a Creditor of a Beneficiary Reach Distributions the Trustee Could, in the Exercise of Its Discretion, Make To or For the Benefit of the Beneficiary by Arguing That the Beneficiary Could Compel the Distribution,[73] and Thus That the Distribution is a Mandatory One That is Subject to the Creditor's Claim If not Made Within a Reasonable Time?*

No. The argument would be to compel a discretionary distribution the creditor could reach. New section 506(a) explicitly defines "mandatory distributions" to exclude discretionary distributions,[74] and section 504(b) expressly prohibits most creditors from compelling discretionary distribu-

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[70] *See id.* § 506(a), at 261. The amendment was intended to be clarifying: "No change of substance is intended by this amendment." *Id.* § 506 cmt., at 262.

[71] *Id.* § 506(a), at 261. Further, the comment to section 506, also as amended in 2005, states: "Under both sections 504 and 506, a trust is discretionary even if the discretion is expressed in the form of a standard, such as a provision directing a trustee to pay for a beneficiary's support. . . ." *Id.* § 506 cmt., at 262.

[72] *See id.* § 506 & cmt., at 261-62.

[73] While section 504 prohibits most creditors of a beneficiary from compelling distributions, even if the trustee has abused its discretion or failed to comply with a standard for distributions, *see infra* Section IV, the section "does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution." UNIF. TRUST CODE § 504(d) (2005).

[74] *Id.* § 506(a), at 261.

tions.[75]

III. IN THE ABSENCE OF A SPENDTHRIFT PROVISION

If a trust instrument does not include a spendthrift provision, the rights of creditors of a beneficiary who is not a settlor of the trust are addressed in section 501.

A. Is Section 501 Applicable Only to Trusts the Terms of Which Do Not Include Spendthrift Provisions?

Yes. While the answer to that question was not clear under the Code as originally promulgated, the 2005 amendments provided clarification.[76] Section 501 is now applicable only "[t]o the extent a beneficiary's interest is not subject to a spendthrift provision."[77] Its comment explicitly provides that section 501 "applies only if the trust does not contain a spendthrift provision or the spendthrift provision does not apply to a particular beneficiary's interest."[78]

B. If the Instrument Does Not Include a Spendthrift Provision, What Rights Does a Creditor of a Trust Beneficiary Have?

In such a case "the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."[79]

C. If the Instrument Does Not Include a Spendthrift Provision and a Creditor Properly Asserts a Claim Under Section 501, Would the Beneficiary Be Able to Benefit From the Trust Before the Creditor is Paid in Full?

Perhaps. Under section 501, "The court may limit the [creditor's] award to such relief as is appropriate under the circumstances."[80] The comment explains, "In exercising its discretion to limit relief, the court may appropriately consider the circumstances of a beneficiary and the ben-

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[75] *See id.* § 504(b), at 256 ("[A] creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if . . . the discretion is expressed in the form of a standard of distribution . . . ."). *See also infra* Section IV (discussing § 504(b)).

[76] *See supra* note 51.

[77] UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005).

[78] *Id.* § 501 cmt.

[79] *Id.* § 501.

[80] *Id.*

eficiary's family."[81]

D. In the Absence of a Spendthrift Provision, Do the Creditor's Rights Depend on Whether the Beneficiary Has a Right to Receive Mandatory Distributions or Whether Distributions Are At the Trustee's Discretion?

Yes.

1. What If the Beneficiary Has a Right to Receive Mandatory Distributions?

If the beneficiary is entitled to receive mandatory distributions, or to have them made for the beneficiary's benefit (for example, all income, a unitrust amount, or one-third of the trust assets upon reaching a designated age), the creditor's remedies include attaching those distribution rights.[82] In that case, the trustee must pay the creditor instead of the beneficiary part or all of the amount[83] distributable to or for the benefit of the beneficiary.[84]

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[81] *Id.* § 501 cmt., at 251. Prior to its amendment in 2005, the comment referred not to the "circumstances" of the beneficiary and the beneficiary's family, but to their "support needs." UNIF. TRUST CODE § 501 cmt. (2004), 7C U.L.A. 251 (Supp. 2005) (amended 2005). The change was made to avoid a potential argument that a supplemental needs trust could be treated as available for the beneficiary's support and thus disqualify the beneficiary from receiving public benefits.

[82] *See* UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005).

[83] *See supra* notes 80-1 and accompanying text.

[84] The comment to section 501 notes that it

> does not prescribe the procedures . . . for reaching a beneficiary's interest or of priority among claimants, leaving those issues to the enacting state's laws on creditor rights. The section does clarify, however, that an order obtained against the trustee, whatever state procedure may have been used, may extend to future distributions whether made directly to the beneficiary or to others for the beneficiary's benefit. By allowing an order to extend to future payments, the need for the creditor periodically to return to court will be reduced.

UNIF. TRUST CODE § 501 cmt. (amended 2005), 7C U.L.A. 250 (Supp. 2005). Prior to its amendment in 2005, the comment also included a general description of the process by which a creditor would pursue its claim, along with the statement that the creditor could, "in theory, force a judicial sale of a beneficiary's interest." UNIF. TRUST CODE § 501 cmt. (2004), 7C U.L.A. 250-51 (Supp. 2005) (amended 2005). The 2005 amendment of the comment deleted the general description and the reference to a judicial sale. *See* UNIF. TRUST CODE § 501 cmt. (amended 2005), 7C U.L.A. 250-51 (Supp. 2005).

2. What If There is No Spendthrift Provision and Distributions Are At the Trustee's Discretion Instead of Mandatory?

If the trustee is authorized to make discretionary distributions to or for the benefit of the beneficiary, most creditors of the beneficiary may not compel the trustee to exercise its discretion to make distributions they can reach.[85] If, however, the trustee decides to make a discretionary distribution to or for the benefit of the beneficiary (and the terms of the trust do not include a spendthrift provision), part or all[86] of the distribution must be paid to the creditor. Case law in a number of states supports the UTC's approach of allowing a beneficiary's creditor to attach future discretionary distributions (in the absence of a spendthrift provision).[87] On the other hand, case law in other states denies this remedy to creditors,[88] and it is likely that some states have not yet addressed this issue.

E. If the Terms of the Trust Do Not Include a Spendthrift Provision, Would a Creditor Be Able to Force a Judicial Sale of the Beneficiary's Interest?

Perhaps. Section 501 provides that in the absence of a spendthrift provision, a beneficiary's creditor may reach the beneficiary's interest by attachment "or other means."[89] Creditors' remedies under section 501, however, are at the court's discretion, as the section provides, "To the extent a beneficiary's interest is not subject to a spendthrift provision, the court *may authorize* a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."[90] The remedy a court would

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[85] *See infra* Section IV.

[86] *See supra* notes 80-81 and accompanying text.

[87] *See* RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmts. b and c, at 417-18 (2003). *See also* RESTATEMENT (SECOND) OF TRUSTS § 155(2) (1959) (stating that a trustee of a discretionary trust who has notice of a creditor's claim and who makes a discretionary distribution to the beneficiary is liable to the creditor for the amount of the distribution).

[88] *See, e.g.*, Samson v. Bertok, No. WD-83-3, 1986 WL 14819 (Ohio Ct. App. Dec. 19, 1986); Shelley v. Shelley, 354 P.2d 282, 289 (Or. 1960).

[89] UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005).

[90] *Id.* (emphasis added). Prior to its amendment in 2005, the comment to section 501 noted: "The creditor may also, in theory, force a judicial sale of a beneficiary's interest." UNIF. TRUST CODE § 501 cmt. (2004), 7C U.L.A. 251 (Supp. 2005) (amended 2005). That statement, along with the rest of the paragraph in which it was included, was deleted from the comment in 2005. *See* UNIF. TRUST CODE § 501 cmt. (amended 2005), 7C U.L.A. 250-51 (Supp. 2005).

authorize in a given situation likely would depend on the circumstances.[91]

1. What Would Guide a Court in Deciding Whether to Order a Judicial Sale of a Beneficiary's Interest?

The UTC does not address this question. Under section 106: "The common law of trusts and principles of equity supplement this [Code], except to the extent modified by this [Code] or another statute of this State."[92] Thus, if an enacting state had case law on this subject,[93] a court presumably would follow it. A court might also look to the Restatements.[94] Under the Third Restatement, a beneficiary's discretionary trust interest is not subject to execution sale.[95] Under the Second Restatement: "If the interest of the beneficiary of a trust is so indefinite or contingent that it cannot be sold with fairness to both the creditors and the beneficiary, it cannot be reached by his creditors."[96]

2. Is the UTC's Allowance of a Judicial Sale of a Beneficiary's Interest (In the Absence of a Spendthrift Provision) a Change in the Common Law?

No. A beneficiary's interest in a trust "is now generally recognized as a property right and liable for the beneficiary's debts equally with his legal interests, unless specially exempted by statute or by direction of the settlor."[97] The general rule of the Second Restatement is that "creditors of the beneficiary of a trust can by appropriate proceedings reach his interest and thereby subject it to the satisfaction of their claims against him."[98] It is

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[91] As noted in Professor Scott's treatise: "In a proceeding in equity to reach the interest of the beneficiary of a trust, the court will give to the creditor such relief as is under all the circumstances fair and reasonable." 2A SCOTT & FRATCHER, *supra* note 3, § 147.2.

[92] UNIF. TRUST CODE § 106 (amended 2005), 7C U.L.A. 204 (Supp. 2005) [alteration in original].

[93] *See, e.g.*, Showalter v. G. H. Nunnelley Co., 257 S.W. 1027 (Ky. 1924) (appointing a receiver to provide for the payment of the debt of an income beneficiary out of trust income, rather than ordering a sale of the interest, because of concerns that a sale would prejudice both the creditor and the debtor/beneficiary).

[94] The comment to section 106 notes the Restatements as sources of the common law of trusts and principles of equity that supplement the Code. *See* UNIF. TRUST CODE § 106 cmt. (amended 2005), 7C U.L.A. 204 (Supp. 2005).

[95] *See* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. c (2003).

[96] RESTATEMENT (SECOND) OF TRUSTS § 162 (1959).

[97] GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 193 (rev. 2d ed. 1979) (footnote omitted).

[98] RESTATEMENT (SECOND) OF TRUSTS § 147 (1959). *See also* 2A SCOTT & FRATCHER,

clear that this rule contemplates judicial sales of beneficial interests because under the exception in the Second Restatement, such a sale is not allowed if it could not be accomplished in a fair manner to both the beneficiary and the creditor.[99] Given the almost universal use of spendthrift provisions,[100] the UTC's limitation of the remedies available to spendthrift exception creditors to attachment,[101] and the prohibition on sales of discretionary interests under the Third Restatement, judicial sales of beneficial interests in a UTC enacting jurisdiction should continue to be very rare.

IV. THE INABILITY OF CREDITORS OF BENEFICIARIES TO COMPEL DISCRETIONARY DISTRIBUTIONS THEY CAN REACH

Section 504 addresses whether a creditor of a beneficiary of a discretionary trust may compel distributions the creditor can reach. The section applies regardless of whether the trust instrument includes a valid spendthrift provision.[102]

A. May a Creditor of a Beneficiary of a Third-party Created Trust Force the Trustee to Make Discretionary Distributions the Creditor Can Reach?

Generally, no. In another departure from the Third Restatement (that may be more apparent than real[103]), section 504(b) provides the general

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supra note 3, § 147.2; BOGERT & BOGERT, *supra* note 97, § 193.

[99] *See* RESTATEMENT (SECOND) OF TRUSTS § 162 (1959).

[100] *See* Alan Newman, *The Rights of Creditors of Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771, 777 n.36 (2002). Note, however, that while spendthrift provisions provide substantial protection against claims of beneficiaries' creditors, they reduce beneficiaries' flexibility in dealing with their trust interests. *See* KATHRYN G. HENKEL, ESTATE PLANNING AND WEALTH PRESERVATION ¶ 4.02[2][d] (1997); JOHN R. PRICE, PRICE ON CONTEMPORARY ESTATE PLANNING 896-97 (1992); Howard M. Zaritsky, *A QPRT Checklist*, PROB. PRAC. REP., May 2000, at 1, 3-4.

[101] *See* UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[102] *See id.* § 504(b), at 256.

[103] *See* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e (2003). Under comment e to section 60, a beneficiary's creditor, as well as the beneficiary, is entitled to judicial protection against an abuse of discretion by the trustee. *Id.* However, the comment also provides that a trustee's exercise of its discretion might not be actionable by a creditor in circumstances when it would be actionable by the beneficiary. *Id.* The explanation for the difference in treatment is that:

> [T]he extent to which the designated beneficiary might actually benefit from a distribution is relevant to the justification and reasonableness of the trustee's decision in relation to the settlor's purposes and the effects on other beneficiaries. Thus, the balancing process typical of discretionary issues becomes, in this

rule: "[W]hether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if: (1) the discretion is expressed in the form of a standard of distribution; or (2) the trustee has abused the discretion."[104]

1. What If the Trust Terms Require the Trustee to Make Distributions for the Beneficiary's Support?

Section 504(b) prohibits most creditors from compelling a distribution "that is subject to the trustee's discretion."[105] If the terms of the trust require distributions for support (for example, "the trustee shall make distributions of income and principal for the beneficiary's support"), an argument can be made that the prohibition of section 504(b) is not applicable, because the required support distributions arguably would not be subject to the trustee's discretion within the meaning of section 504(b). For at least four reasons, this argument would fail. First, section 504(b)(1) makes the general rule applicable to discretionary distributions "even if . . . the discretion is expressed in the form of a standard of distribution."[106] Thus, the use of a standard of distribution in the terms of the trust is treated by the statute as a grant of discretion over distributions. Second, the comment to section 504 notes that the section does not distinguish between support and discretionary trusts, and the comment refers to a provision in the Third Restatement under which support trusts are treated as discretionary trusts with support standards.[107] Third, if the terms—"the trustee shall make distributions of income and principal for the beneficiary's support"—are not treated as providing for distributions at the trustee's discretion, presumably they would be treated as calling for mandatory distributions. As discussed in Section II.K.1, above, however, the 2005 amendments to the UTC explicitly define mandatory distributions to exclude distributions pursuant to a standard. Fourth, the comment to section 506, as amended in 2005, explicitly states that a trust is discretionary even if it includes "a provision directing a trustee to pay for a beneficiary's support."[108]

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context, significantly weighted against creditors . . . .

Id.

[104] UNIF. TRUST CODE § 504(b) (amended 2005), 7C U.L.A. 256 (Supp. 2005).

[105] *Id.*

[106] *Id.* § 504(b)(1).

[107] *See id.* § 504 cmt. (citing RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. a, at 414-17 (2003)).

[108] UNIF. TRUST CODE § 506 cmt. (amended 2005), 7C U.L.A. 262 (Supp. 2005).

2. If the Creditor's Claim is Based On Having Provided Support to the Beneficiary, and the Trust Terms Include a Support Standard For Distributions, May the Creditor Compel Distributions It Can Reach to Reimburse It For the Support It Provided To the Beneficiary?

No. Under the UTC, no creditor of a beneficiary (including the state) may compel discretionary distributions to satisfy claims based on the creditor's having provided support to the beneficiary.[109] In this regard, the UTC provides greater protection against creditors' claims than does the law in some states.[110]

B. Does the UTC Allow Any Creditor of a Beneficiary of a Third-party Created Trust to Compel Distributions the Creditor Can Reach?

Yes. There is an exception to the general rule of section 504(b). Under section 504(c)(1), in specified circumstances the court may order discretionary distributions that the beneficiary's child, spouse, or former spouse can reach.[111]

1. Under What Circumstances May Such a Creditor Compel Distributions the Creditor Can Reach?

The ability of a beneficiary's child, spouse, or former spouse to compel discretionary distributions he or she can reach is limited in three ways. First, the child, spouse, or former spouse must have a judgment or court order against the beneficiary for support or maintenance.[112] Second, section 504(c)(1) authorizes but does not require the court to order a distribution to satisfy such a judgment or court order.[113] Third, such an order may be entered only "[t]o the extent a trustee has not complied with a standard

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[109] *See id.* § 504(b), at 256.

[110] *See, e.g.*, Estate of Lackmann v. Dep't of Menial Hygiene, 320 P.2d 186, 189 (Cal. Ct. App. 1958); Constanza v. Verona, 137 A.2d 614, 617 (N.J. Super. Ct. Ch. Div. 1958); Bureau of Support v. Kreitzer, 243 N.E.2d 83, 85 (Ohio 1968); Cronin's Case, 192 A. 397, 401 (Pa. 1937); State v. Rubion, 308 S.W.2d 4, 11 (Tex. 1957). *See also* 2A SCOTT & FRATCHER, *supra* note 3, § 157.2.

[111] *See* UNIF. TRUST CODE § 504(c)(1) (amended 2005), 7C U.L.A. 256 (Supp. 2005). Note that because these creditors also are exception creditors for spendthrift protection under section 503(b), they may compel distributions from discretionary spendthrift trusts. *See id.* § 503(b)(1), at 253.

[112] *See id.* § 504(c)(1), at 256.

[113] *See id.*

of distribution or has abused a discretion."[114] Presumably, the burden will be on the creditor to establish the trustee's failure to comply with a standard of distribution or abuse of discretion.

2. *Would the Court Order the Trustee to Satisfy the Entire Amount of the Unpaid Child or Spousal Support or Alimony?*

Presumably a court often would do so, but that will not necessarily be the case. Rather, the amount awarded to the child, spouse, or former spouse for back support would depend on the circumstances. Under section 504(c)(2), the court is to order payment to the child, spouse, or former spouse of "such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion."[115] According to the comment to the section, however, "Before fixing this amount, the court . . . should consider that in setting the respective support award, the family court has already considered the respective needs and assets of the family."[116]

3. *Under Non-UTC Trust Law, May a Beneficiary's Child, Spouse, or Former Spouse, With a Court Order or Judgment For Support or Maintenance, Compel Discretionary Distributions They Can Reach?*

As noted by the Third Restatement, there is authority—in the context of a trust for the support of the beneficiary—for this policy-oriented rule of the UTC,[117] but it likely would make new law in many jurisdictions, particularly for trusts that do not include support standards for discretionary distributions.[118]

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[114] *Id.* § 504(c).

[115] *Id.* § 504(c)(2).

[116] *Id.* § 504 cmt.

[117] *See* RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. e, at 419-23 (2003). *See also* RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. b (1959). For a recent case that upheld a lower court's order directing the trustee of a third-party created discretionary support trust to pay the beneficiary's child support obligations, see Drevenik v. Nardone, 862 A.2d 635 (Pa. Super. Ct. 2004).

[118] *See* 2A SCOTT & FRATCHER, *supra* note 3, § 155. *See also* Carolyn L. Dessin, *Feed a Trust and Starve a Child: The Effectiveness of Trust Protective Techniques Against Claims for Support and Alimony*, 10 GA. ST. U. L. REV. 691 (1994) (discussing statutory enactments and case interpretations from numerous jurisdictions); M.L. Cross, Annotation, *Trust Income or Assets as Subject to Claim Against Beneficiary for Alimony, Maintenance, or Child Support*, 91 A.L.R.2d 262 (1963) (discussing whether, and the extent to which, the

4. Does the Inability of Creditors (Other Than a Child, Spouse, or Former Spouse With a Judgment or Court Order for Support or Maintenance) to Compel Discretionary Distributions Affect the Beneficiary's Ability to Do So?

No. Section 504(d) provides: "This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution."[119]

V. CREDITORS' CLAIMS AGAINST A BENEFICIARY/SETTLOR

If a beneficiary also is a settlor of a trust, the rights of the beneficiary/settlor's creditors under the UTC are governed by section 505.

A. May the Creditors of a Settlor of a Revocable Trust Reach the Trust Assets During the Settlor's Lifetime?

Yes. Section 505(a) so provides, regardless of whether the terms of the trust include a spendthrift provision.[120]

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income or corpus of a trust is subject to a claim against the beneficiary of the trust for alimony, maintenance, or child support). The UTC's exception allowing a child, spouse, or former spouse with a judgment or court order for support to compel discretionary distributions has been deleted in five of the first twelve jurisdictions that adopted a version of the UTC: Arkansas (*see* 2005 Ark. Acts § 28-73-504); Kansas (*see* KAN. STAT. ANN. § 58a-502 (Supp. 2004)); Maine (*see* ME. REV. STAT. ANN. tit. 18B, § 504 (Supp. 2004)); Tennessee (*see* TENN. CODE ANN. § 35-15-504 (Supp. 2004)); and Missouri (*see* MO. ANN. STAT. § 456.5-504 (Supp. 2005)). Wyoming and Virginia provide the protection of section 504(c) to child support, but not spousal support, claimants. *See* WYO. STAT. ANN. § 4-10-504 (2005); 2005 Va. Acts ch. 31, § 55-545.04.C. The section 504(c) exception has been enacted in New Mexico (*see* N.M. Stat. Ann. § 46A-5-504 (LexisNexis 2004); Nebraska (*see* NEB. REV. STAT. ANN. § 30-3849 (Supp. 2004)); Utah (*see* UTAH CODE ANN. § 75-7-504 (Supp. 2005)); and New Hampshire (*see* N.H. REV. STAT. ANN. § 564-B:5-504 (Supp. 2004)). The District of Columbia's UTC enactment does not include section 504 at all, but reserves the appropriate section number. *See* D.C. CODE ANN. § 19-1305.04 (LexisNexis 2005).

[119] UNIF. TRUST CODE § 504(d) (amended 2005)., 7C U.L.A. 256 (Supp. 2005).

[120] *See id.* § 505(a)(1), at 258. While the UTC does not explicitly recognize homestead rights and other exemptions from creditors' claims under other state law as limitations on creditors' rights under section 505(a), it cites a comment to the Third Restatement that does so. *See id.* § 505 cmt. (2005) (citing RESTATEMENT (THIRD) OF TRUSTS § 25 cmt. e (2003)) (explaining that property held in a revocable trust is subject to claims of the settlor's creditors "if the same property belonging to the settlor . . . would be subject to the claims of the creditors, taking account of homestead rights and other exemptions."). Further, the General Comment to section 505 explicitly states that Article 5 does not supersede state exemption statutes (nor state fraudulent transfer acts). *See* UNIF. TRUST CODE Art. 5, gen. cmt.

1. Is the Holder of a Power of Withdrawal From a Third-party Created Trust Treated as the Settlor of a Revocable Trust for Creditors' Rights Purposes?

Yes, but only during the period the power may be exercised, and only to the extent of the property subject to the power.[121]

2. Does That Mean That the Creditor of a Crummey Power Holder May Reach Property Subject to the Crummey Withdrawal Right?

Yes, but again, only during the period the power may be exercised. In order to reach property subject to the withdrawal power, the creditor would need "to take action prior to the expiration of the [withdrawal] period."[122] The question of what action the creditor would need to take during the withdrawal period is not addressed.

3. If the Power Holder Allows the Power to Lapse, or Releases or Waives It, Will the Power Holder Thereafter Be Treated As the Settlor of a Revocable Trust For Creditors' Rights Purposes As to a Portion of the Trust Determined by Reference to the Amount the Power Holder Could Have, But Did Not, Withdraw?

The power holder will not be treated in that way if the amount subject to withdrawal was limited to the greater of the federal gift tax annual exclusion amount[123] (determined without regard to gift splitting) or the five or five amount[124] under the Internal Revenue Code. For any excess, such as that which would exist when a hanging power is used and is outstanding, the power holder will be treated as the settlor of a revocable trust for creditors' rights purposes.[125]

4. Is the UTC's Treatment of the Holder of a Power of Withdrawal As the Settlor of a Revocable Trust For Creditors' Rights Purposes a Change in the Common Law?

According to the Restatement (Second) of Property, this rule of the UTC is inconsistent with the law of most states.[126] Non-UTC law is not

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(amended 2005), 7C U.L.A. 250 (Supp. 2005).

[121] *See id.* § 505(b)(1), at 258.

[122] *Id.* § 505 cmt., at 259.

[123] *See* I.R.C. § 2503(b) (2000).

[124] *See id.* §§ 2041(b)(2), 2514(e) (2000).

[125] *See* UNIF. TRUST CODE § 505(b)(2) (amended 2005), 7C U.L.A. 258 (Supp. 2005).

[126] *See* RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 13.2, Reporter's

uniform on this subject, however. The rule under the Restatement (Second) of Property is that creditors of an unexercised, presently exercisable general power of appointment may not reach the property subject to the power except to the extent a statute provides otherwise.[127] Statutes in a number of states include such a provision,[128] although in most, creditors may reach the appointive assets only if other property available for payment of their claims is insufficient.[129] The rule under the Restatement (Third) of Trusts,[130] and under federal bankruptcy law,[131] is that the power holder's creditors may reach property subject to a presently exercisable general power of appointment. Case law in several states is to the contrary,[132] as are statutes in Alaska and Rhode Island that do not allow a power holder's creditors to reach the property subject to the power unless it not only is a general power, but also is exercised in favor of the holder, the holder's estate, or the creditors of either.[133] The rationale for the UTC rule, which treats "a power of withdrawal as the equivalent of a power of revocation [is that] the two powers are functionally equivalent."[134]

5. *May a Beneficiary Serve As a Trustee Of a Third-party Created Trust (For Example, a Surviving Spouse As Trustee of a Credit Shelter Trust) Without Being Treated As the Settlor of a Revocable Trust For Creditors' Rights Purposes?*

Section 505(b)(1) provides that the holder of a "power of withdrawal"

Note (1986).

[127] *See* RESTATEMENT (SECOND) OF PROPERTY: DONATIVE TRANSFERS § 13.2 (1986).

[128] *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW §§ 10-7.2, 10-7.4 (McKinney 1998).

[129] *See* CAL. CIV. CODE § 1390.3 (West 1982); MICH. COMP. LAWS ANN. § 556.123 (West 1988); MINN. STAT. ANN. § 502.70 (West 2002); OKLA. STAT. ANN. tit. 60, § 299.9 (West 1994); WIS. STAT. ANN. § 702.17 (West 2001).

[130] *See* RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. b (2003).

[131] *See* 11 U.S.C.A. § 541(b) (West 1994).

[132] *See, e.g.*, Univ. Nat'l Bank v. Rhoadarmer, 827 P.2d. 561 (Colo. Ct. App. 1991); Irwin Union Bank & Trust Co. v. Long, 312 N.E.2d 908 (Ind. Ct. App. 1974).

[133] *See* ALASKA STAT. § 34.40.115 (2004); R.I. GEN. LAWS § 34-22-13 (1995).

[134] UNIF. TRUST CODE § 505 cmt. (amended 2005), 7C U.L.A. 259 (Supp. 2005). For criticisms of the traditional rule under which creditors of the holder of a presently exercisable general power of appointment may not reach property subject to the power, see 5 AMERICAN LAW OF PROPERTY § 23.17 (A.J. Casner ed. 1952); LEWIS SIMES & ALLEN F. SMITH, FUTURE INTERESTS § 944 (2d ed. 1956); Lawrence Berger, *The General Power of Appointment as an Interest in Property*, 40 NEB. L. REV. 104, 119-20 (1960); Olin L. Browder, Jr., *Future Interest Reform*, 35 N.Y.U. L. REV. 1255, 1272 (1960); Roy Lee Steers, Jr., Note, *Creditors' Ability to Reach Assets Under a General Power of Appointment*, 24 VAND. L. REV. 367 (1971).

is treated as the settlor of a revocable trust (during the period the power may be exercised and with respect to the property subject to the power).[135] The term "power of withdrawal" initially was defined as "a presently exercisable general power of appointment other than a power exercisable only upon consent of the trustee or a person holding an adverse interest."[136] Although the UTC does not define a "presently exercisable general power of appointment,"[137] arguably a trustee/beneficiary's power to distribute to him or herself, even if limited by an ascertainable standard relating to health, education, maintenance, or support, would be a power that would cause the trustee/beneficiary to be treated as the settlor of a revocable trust for creditors' rights purposes under section 505(b)(1).[138] To avoid that result, the definition of "power of withdrawal" was amended in 2004 to exclude a power "exercisable by a trustee and limited by an ascertainable standard."[139] The 2004 amendments also defined "ascertainable standard" as one relating to an individual's health, education, support, or maintenance.[140] Accordingly, a beneficiary may serve as trustee of a third-party created trust without being treated as the settlor of a revocable trust for creditors' rights purposes, if the beneficiary's power to distribute to him or herself is limited by the requisite ascertainable standard.

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[135] UNIF. TRUST CODE § 505(b)(1) (amended 2005), 7C U.L.A. 258 (Supp. 2005).

[136] UNIF. TRUST CODE § 103(10) (2000), 7C U.L.A. 192 (Supp. 2005) (amended 2005).

[137] *See* UNIF. TRUST CODE § 103 (amended 2005), 7C U.L.A. 191-92 (Supp. 2005).

[138] *See* RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. b (2003) (referring to such a power as one by which the property may be appointed to the donee); *id.* § 60 cmt. g (noting that a trustee-beneficiary's "rights and authority represent a limited form of ownership equivalence analogous to certain general powers"); RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 cmt. a (1986) (providing that powers of appointment may be held in a fiduciary as well as in a non-fiduciary capacity). A power of distribution held by a fiduciary was not, however, a "power of appointment" under the Restatement (First) of Property. RESTATEMENT OF PROP. § 318(2) (1940). Also, note that the definition of "power of withdrawal" under section 103(11) of the UTC excludes a power if it is exercisable only with the trustee's consent. *See* UNIF. TRUST CODE § 103(11) (amended 2005), 7C U.L.A. 192 (Supp. 2005). Whether that exclusion would prevent a trustee/beneficiary from being treated as the holder of a power of withdrawal, and thus the settlor of a revocable trust for creditors' rights purposes, was not clear.

[139] *See* UNIF. TRUST CODE § 103(10) (2004), 7C U.L.A. 192 (Supp. 2005) (amended 2005).

[140] *See id.* § 103(2), at 191.

6. If a Trustee/Beneficiary's Power to Distribute To Him or Herself Is Not Limited by an Ascertainable Standard, Will the Trustee/Beneficiary Be Treated as the Settlor of a Revocable Trust For Creditors' Rights Purposes?

The analysis of the UTC prior to its 2004 amendments described in the answer to the preceding question arguably leads to that conclusion. Further, an inference to that effect may be drawn from the 2004 amendment to the definition of "power of withdrawal," under which a power exercisable by a trustee/beneficiary is not treated as a power of withdrawal if it is limited by an ascertainable standard. A comment to the 2004 amendments, however, notes: "The Code does not specifically address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee that is not limited by an ascertainable standard."[141]

B. May the Creditors of a Settlor of a Revocable Trust Reach the Trust Assets After the Settlor's Death?

Subject to two limitations, yes, as may creditors for (i) costs of administration of the settlor's estate, (ii) the expenses of the settlor's funeral and disposal of remains, and (iii) statutory allowances to a surviving spouse and children.[142] First, the settlor may direct the source from which such liabilities will be paid.[143] Second, the trust assets are subject to such liabilities only to the extent the settlor's probate estate is inadequate to satisfy them.[144]

C. May the Creditors of a Settlor of an Irrevocable Trust Reach the Settlor's Beneficial Interest in the Trust?

Yes, regardless of whether the terms of the trust include a spendthrift provision.[145] The UTC rejects the approach taken in recent years in some states under which a settlor may retain a beneficial interest in a trust that is immune from claims of the settlor's creditors.[146] Rather, following the

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[141] *Id.* § 504 cmt., at 257.
[142] *See* UNIF. TRUST CODE § 505(a)(3) (amended 2005), 7C U.L.A. 258 (Supp. 2005).
[143] *Id.*
[144] *Id.*
[145] *See id.* § 505(a)(2).
[146] *See, e.g.*, ALASKA STAT. § 34.40.110(a)-(b) (2004); DEL. CODE ANN. tit. 12, §§ 3570-3576 (2001 & Supp. 2004); MO. REV. STAT. § 456.5-505(3) (West Supp. 2005); NEV. REV. STAT. ANN. § 166.010 (LexisNexis 2003); R.I. GEN. LAWS §§ 18-9.2 (2003); UTAH CODE ANN. § 25-6-14(a)(ii) (Supp. 2005).

traditional common law rule, section 505(a)(2) allows creditors of the settlor to "reach the maximum amount that can be distributed to or for the settlor's benefit."[147]

VI. DISCRETIONARY AND SUPPORT TRUSTS UNDER THE UTC

The UTC's creditors' rights provisions in Article 5 do not distinguish between trusts that traditionally would have been characterized as "discretionary trusts" and those that traditionally would have been characterized as "support trusts."[148] This has been a source of much of its criticism.[149]

A. Does the UTC Eliminate the Distinction Between Discretionary and Support Trusts?

In some ways, the UTC eliminates this distinction; in others it does not. The distinction between the two is eliminated for creditors' rights purposes. The comment to section 504 provides: "This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories."[150] As revised in 2005, however, the comment to section 504 explains:

> By eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both. Other than for a claim by a child, spouse or former spouse, a beneficiary's creditor may not reach the beneficiary's interest. Eliminating this distinction affects only the rights of creditors.... It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. *See* Section 814 comment.[151]

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[147] UNIF. TRUST CODE § 505(a)(2) (amended 2005), 7C U.L.A. 258 (Supp. 2005).
[148] *See id.* § 504 cmt., at 256.
[149] *See, e.g.*, Merric & Oshins, *supra* note 1, at 481-86.
[150] UNIF. TRUST CODE § 504 cmt. (amended 2005), 7C U.L.A. 256 (Supp. 2005).
[151] *Id.* The comment to section 814 cited at the end of the quote in the text provides:
> [W]hether the trustee has a duty in a given situation to make a distribution depends on the exact language used, whether the standard grants discretion and its breadth, whether this discretion is coupled with a standard, whether the beneficiary has other available resources, and, more broadly, the overriding purposes of the trust.

Id. § 814 cmt., at 307.

Thus, while Article 5 treats discretionary trusts with and without support standards alike, it does not address or change the traditional rules that govern the trustee's exercise of discretion in making distributions to or for the benefit of the beneficiary.[152]

1. For Creditors' Rights Purposes, Does the UTC Treat a Trust For the Beneficiary's Support As a Discretionary Trust?

Yes. Under section 504, most creditors of a beneficiary (including those who have provided for the beneficiary's support) may not compel discretionary distributions they can reach regardless of whether the terms of the trust include a support standard.[153] Similarly, if the terms of a trust do not include a spendthrift provision, section 501 applies regardless of whether the trust terms include a support standard, or whether the creditor's claim was for having provided for the beneficiary's support.[154] The comment to section 504 cites the Third Restatement, which provides, "The so-called 'support trust' . . . is viewed here as a discretionary trust with a support standard."[155]

2. Does the UTC Treat a Discretionary Trust Without a Support Standard As a Trust For the Beneficiary's Support?

No. Although section 504 (prohibiting most creditors of the beneficiary from compelling discretionary distributions they can reach) and section 501 (providing creditors' remedies when the terms of the trust do not include a spendthrift provision) do not distinguish between discretionary trusts with and without support standards,[156] with limited exceptions the UTC does not address the rights of beneficiaries—and the duties of trustees—with respect to distributions to be made from such trusts.[157] Because

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[152] For a discussion of the rights and duties of the beneficiary and trustee with respect to distributions, in the context of section 814(a), which establishes outer limits on the trustee's discretion, *see infra* Section VII.

[153] *See supra* Section IV.

[154] *See* UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (amended 2005).

[155] *See id.* § 504 cmt., at 256 (citing RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. a, at 415 (2003)).

[156] *See* UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005); *id.* § 504, at 255-56.

[157] The most important exception to the statement that the UTC does not address distribution issues is section 814(a), under which the trustee must exercise its discretion in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, regardless of how broadly the settlor defines the trustee's discretion. *See id.* § 814(a), at 307. For a discussion of section 814(a), see *infra* Sections VII and VIII. Sec-

the UTC generally does not address those subjects, they would be governed by common law and principles of equity.[158] Thus, a beneficiary's right, if any, to receive a distribution from a discretionary trust, with or without a support standard, would be determined under the same rules under the UTC as it would be without the UTC. Under those rules, a discretionary trust without a support standard may not be treated as a trust for the beneficiary's support.[159]

B. To the Extent It Has Done So, Why Has the UTC Eliminated the Distinction Between Discretionary and Support Trusts?

The comment to section 504, which states that section 504 has eliminated the distinction, refers to the Third Restatement, under which support trusts are treated as discretionary trusts with a support standard.[160] The traditional formal distinction between discretionary trusts and support trusts[161] is described in the Restatement as "arbitrary and artificial," and

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tions 814(b) and (c) also address distributions, but do so to avoid adverse transfer tax consequences that could arise if a trustee whose discretion was not limited by an ascertainable standard related to health, education, maintenance, and support also was a beneficiary of the trust. *See* UNIF. TRUST CODE §§ 814(b) and (c) (amended 2005, 7C U.L.A. 307 (Supp. 2005).

[158] *See* UNIF. TRUST CODE § 106 (amemded 2005), 7C U.L.A. 204 (Supp. 2005).

[159] For example, under the Third Restatement:

> Illustrative of terms that tend to be highly restrictive are those that authorize invasion of principal or other discretionary payments in the event of an "emergency," "severe hardship," "disability," or the like. These are construed as authorizing distributions only when the described conditions or circumstances arise, and then only to the extent appropriate to alleviate the emergency, hardship, or special need.

RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d(4) (2003). If the terms of a trust do not include any standards to guide the trustee's exercise of its discretion, "a general standard of reasonableness, or at least of good-faith judgment, will apply to the trustee . . . , based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the settlor, and the general purposes of the trust." *Id.* cmt. d.

[160] *See* UNIF. TRUST CODE § 504 cmt. (amended 2005), 7C U.L.A. 256 (Supp. 2005) and RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. a, at 414-15 (2003).

[161] The Second Restatement narrowly defines "discretionary trust" and "support trust." A "discretionary trust" is one by the terms of which "it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply." RESTATEMENT (SECOND) OF TRUSTS § 155(1) (1959). A "support trust" is one under which the trustee is required to "pay or apply only so much of the income and principal or either as is necessary for the education or support of the beneficiary." *Id.* § 154. As noted in the Third Restatement, the territory

rejected in part because trust instruments commonly both give the trustee discretion and include support standards.[162] The analysis of an Iowa court in a recent case is similar:

> The definitional distinctions between support and discretionary trusts are limpid. Provisions of particular trusts muddy these clear demarcations. When the provision is equivocal or adheres to principles common to both types of trusts, interpretative inconsistencies abound. . . .
>
> The parties in the present case ask this court to wade into these murky waters without even a life jacket. Each side throws out, as an aid for interpretation, only the specific language of the trust provision that supports their particular contention despite the remaining language to the contrary. . . . The equivocal nature of the provision is obvious. It blends a desire to ensure the basic support needs of a handicapped daughter with the control mechanism of trustee discretion designed to prevent wasteful depletion of the trust's assets. Any attempt by this court to hammer the language of this particular trust provision into one of these rigid categories would only breed further inconsistencies in the law.[163]

Further, even if the terms of a trust mandate distributions for the beneficiary's support, the trustee nevertheless will be required to exercise discretion in deciding how to provide for the beneficiary's support.[164] Similarly, in the event of a serious support need of the beneficiary of a purely discretionary trust, the trustee might be required to make a discretionary

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between discretionary and support trusts as so defined is "vast (yet much traveled)," but not covered by the Second Restatement. *See* RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. a, at 415 (2003).

[162] *See id. See also* Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273, 289 (1983). Whether such trusts should be classified as "discretionary trusts" or "support trusts" has been the subject of much litigation in the public benefits qualification area. For a discussion of the issues raised and many of the cases, see CLIFTON B. KRUSE, JR., THIRD PARTY AND SELF-CREATED TRUSTS—PLANNING FOR THE ELDERLY AND DISABLED CLIENT (3d ed. 2002).

[163] Strojek v. Hardin County Bd. of Supervisors, 602 N.W.2d 566, 569 (Iowa Ct. App. 1999). *See also* Lang v. Dep't. of Public Welfare, 528 A.2d 1335, 1344 (Pa. 1987) ("We believe such a rigid categorization [of trusts as support trusts or discretionary trusts] is unwarranted and ignores the intent of a settlor who includes both support and discretionary language in his trust instrument, by substituting mechanical rules for individual facts.").

[164] *See, e.g.*, Old Colony Trust Co. v. Rodd, 254 N.E.2d 886 (Mass. 1970); Baker v. Brown, 15 N.E. 783 (Mass. 1888).

distribution to meet the beneficiary's need.[165] For these reasons, the Third Restatement concludes "that there is a continuum of discretionary trusts, with the terms of distributive powers ranging from the most objective . . . of standards (pure 'support') to the most open ended (e.g., 'happiness') or vague ('benefit') of standards, or even with no standards manifested at all . . . ."[166]

C. What Effect Does the UTC's Elimination of the Distinction Between Discretionary and Support Trusts Have On the Protection a Spendthrift Provision Provides?

None. Spendthrift protection applies regardless of whether a trust would have been a discretionary trust or a support trust under the Second Restatement rules.[167] Thus, most creditors of a beneficiary of a spendthrift trust may not reach either the beneficiary's interest or the trust assets prior to their receipt by the beneficiary regardless of whether the trustee is given discretion without a standard (for example, "the trustee may at its absolute discretion make distributions of income and principal to or for the beneficiary"), directed to make distributions for the beneficiary's support (for example, "the trustee shall distribute income and principal to provide for the beneficiary's support"), or given discretion to make distributions for the beneficiary's support (for example, "the trustee may in its discretion make distributions of income and principal for the beneficiary's support").[168]

D. What Effect Does the UTC's Elimination of the Distinction Between Discretionary and Support Trusts Have On the Protection Afforded By the UTC's Rule Prohibiting Most Creditors From Compelling Discretionary Distributions They Can Reach?

None. Subject to the narrow exception for a beneficiary's child, spouse, or former spouse with a judgment or court order for support,[169] a

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[165] *See, e.g.*, Morris v. Daiker, 172 N.E. 540, 542 (Ohio Ct. App. 1929).

[166] RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. a, at 416 (2003).

[167] *See* UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005).

[168] For discussions of spendthrift exception creditors and the rights of a beneficiary's creditor when the trustee does not make mandatory distributions within a reasonable time after their due date, see *supra* Sections II.C through H and II.K, respectively. *See also infra* Section VI.E for a discussion of the effect of the elimination of the distinction between discretionary and support trusts when the trust instrument includes a spendthrift provision, but the creditor's claim is not barred by it.

[169] *See* UNIF. TRUST CODE § 504(c)(1) (amended 2005), 7C U.L.A. 256 (Supp. 2005).

beneficiary's creditor may not compel discretionary distributions it can reach regardless of whether the trust is purely discretionary, mandatory for the beneficiary's support, or a hybrid of the two.[170] Thus, section 504(b) extends to support trusts the protection discretionary trusts have traditionally afforded against creditors of beneficiaries seeking to compel distributions they can reach. In this way, the UTC enhances asset protection planning with trusts.

E. What Effect Does the UTC's Elimination of the Distinction Between Discretionary and Support Trusts Have On the Rights of Creditors Of a Beneficiary If the Trust's Terms Do Not Include a Spendthrift Provision, or If the Instrument Includes Such a Provision, But the Creditor's Claim Is Not Barred By It?

In the rare case of a trust that is not subject to a spendthrift provision,[171] section 501 allows a beneficiary's creditor to reach the beneficiary's interest by attachment or other means[172] (but not by compelling discretionary distributions[173]). If the terms of the trust include a spendthrift provision, but the creditor's claim is not barred by it,[174] the remedy provided to the exception creditor by section 503(c) is attachment of present or future distributions.[175] Neither section 501 nor section 503 distinguishes between trusts that are purely discretionary, mandatory for support, or a hybrid of the two. Similarly, no distinction is made by either section between claims of creditors that are based on having provided support to the beneficiary and other claims. Thus, if a trust is for the beneficiary's support and its terms do not include a spendthrift provision (or if the instrument includes a spendthrift provision but the creditor is an exception creditor), a creditor of a beneficiary whose claim is not based on having provided support to the beneficiary may attach, under section 501 or 503, future distributions the trustee chooses to make.[176] By contrast, under the Second Restatement, creditors who provided support to the beneficiary of

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[170] *See id.* § 504(b).

[171] *See supra* note 100 and accompanying text.

[172] *See* UNIF. TRUST CODE § 501 (amended 2005), 7C U.L.A. 250 (Supp. 2005).

[173] *See id.* § 504(b), at 256.

[174] *See supra* Sections II.C. through II.I.

[175] *See* UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[176] Both section 501 and section 503, however, authorize the court to limit the creditor's award "to such relief as is appropriate under the circumstances." *See id.* § 501, at 250 and 503(c), at 253.

a support trust may reach the beneficiary's interest,[177] but other creditors may not.[178] Consistent with its not distinguishing between discretionary and support trusts, the Third Restatement allows creditors whose claims are not based on having provided support to a beneficiary to reach the beneficiary's interest in a non-spendthrift trust, without regard to whether the trust was for the beneficiary's support.[179]

VII. SUBSECTION 814 (a): MAY THE BENEFICIARY COMPEL DISCRETIONARY DISTRIBUTIONS?

The UTC provides little guidance about the rights of beneficiaries and the duties of trustees for discretionary distributions.[180] Rather, discretionary distribution issues are left largely to case law of the jurisdiction the law of which governs.[181]

A. Does the UTC Increase the Ability of the Beneficiary of a Discretionary Trust to Compel Distributions? If So, Does That Increase the Ability of Creditors of the Beneficiary to Reach the Beneficiary's Interest Or the Trust's Assets?

There are three initial points to make. First, section 504(d) provides that section 504 (which generally prohibits a beneficiary's creditors from compelling discretionary distributions they can reach)[182] does not limit the beneficiary's right to maintain an action against the trustee for abuse of

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[177] RESTATEMENT (SECOND) OF TRUSTS § 157(b) (1959). Generally, at common law, if a creditor of a beneficiary of a support trust provides support to the beneficiary, the creditor may recover directly from the trust if it would have been an abuse of discretion for the trustee not to have expended trust funds to have procured the goods or services for the beneficiary. 2A SCOTT & FRATCHER, *supra* note 3, § 157.2.

[178] *See* RESTATEMENT (SECOND) OF TRUSTS § 154 (1959). Comment e to section 154 provides:

> [T]he trustee is not liable to the . . . creditor [whose claim is not based on having provided support to the beneficiary] though the trustee pays to or applies for the beneficiary so much of the property as is necessary for his education or support, even though the trustee . . . has been served with process in proceedings instituted by the creditor to reach the interest of the beneficiary.

Id. at cmt. c. *See also* Robert R. Young & T. Lauer, Note, *Creditor's Rights in Support Trusts*, 1956 WASH. U. L.Q. 106 (1956).

[179] *See* RESTATEMENT (THIRD) OF TRUSTS § 60 (2003). *See also* Goforth v. Gee, 975 S.W.2d 448 (Ky. 1998).

[180] *See* UNIF. TRUST CODE § 504(d) (amended 2005), 7C U.L.A. 256, § 504 cmt., at 256-57, § 814(a), at 307, § 814 cmt., at 307-09 (Supp. 2005).

[181] *See id.* § 814(a) cmt., at 307-09.

[182] *See supra* Section IV.

discretion or failure to comply with a standard of distribution.[183] Section 504(d) does not grant the beneficiary a new right to compel distributions. Rather, it affirms that the right a beneficiary has to compel distributions when the trustee has abused its discretion or failed to comply with a standard of distribution[184] is not affected by the inability of his or her creditors to do so. Second, section 504(b) explicitly prohibits most creditors of a beneficiary from compelling discretionary distributions they can reach.[185] Because that prohibition applies without regard to whether the beneficiary may compel distributions,[186] the right, if any, the beneficiary may have to compel distributions has no effect on creditors' inability to do so. Third, if the terms of the trust include a valid spendthrift provision, most creditors may not reach the beneficiary's interest or the trust assets before their receipt by the beneficiary from a distribution by the trustee, regardless of the beneficiary's rights to compel discretionary distributions (or even if the beneficiary has a mandatory right to receive distributions).[187]

These two questions also arise in connection with concerns that have been expressed about the effect of the UTC in the contexts of special or supplemental needs trusts, divorce, and bankruptcy, which are discussed in Sections IX, X, and XI.

B. Does Subsection 814(a) Give the Beneficiary of a Discretionary Trust an Enforceable Property Right to Compel Discretionary Distributions?[188]

As a threshold matter, whether a beneficiary of a trust has a property

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[183] *See* UNIF. TRUST CODE § 504(d) (amended 2005), 7C U.L.A. 256 (Supp. 2005).

[184] As noted by the Second Restatement, for example, "if the trustee is empowered to apply so much of the trust property as he may deem necessary for the support of the beneficiary," the court will override the trustee's decision if the amount the trustee applies is unreasonably high or low for the beneficiary's support. RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. i (1959).

[185] *See supra* Section IV.

[186] *See* UNIF. TRUST CODE § 504(b) (amended 2005), 7C U.L.A. 256 (Supp. 2005). For a recent case that acknowledged differences in the rights of creditors and beneficiaries to compel discretionary distributions, see Corcoran v. Dep't of Soc. Servs., 859 A.2d 533, 543 (Conn. 2004) ("The right of a creditor to reach the trust is not determinative of the right of the beneficiary to do so. It is possible for a trustee to be ordered to make payment to the beneficiary even when the creditor cannot similarly force payment from the trust."). *See also supra* note 103 (discussing RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e (2003)).

[187] *See* UNIF. TRUST CODE § 502 (amended 2005), 7C U.L.A. 251-52 (Supp. 2005); *id.* § 503, at 253. For a discussion, *see supra* Section II.

[188] For an argument to that effect, see Merric & Oshins, *supra* note 1, at 481.

interest in the trust's assets or merely a personal right against the trustee with respect to its administration of the trust's assets has long been the subject of debate.[189] While no consensus has developed on this question, the prevalent view is that a trust beneficiary has a property interest in the trust's assets as well as rights against the trustee to enforce the proper administration of the trust.[190] Subsection 814(a) provides:

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute," "sole," or "uncontrolled," the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[191]

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[189] *See generally*, BOGERT & BOGERT, *supra* note 97, § 183; RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 2, at 24-29 (2003).

[190] "[T]here is probably general agreement in the United States today that a trust involves a division of legal and equitable ownership . . . ." RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 2, at 24 (2003). Similarly:

> The nature of the beneficiary's rights would seem to be summarized by the statement that while the right of the beneficiary originally was solely in personam against the trustee, it has become increasingly a right in rem and is now substantially equivalent to equitable ownership of the trust res. The beneficiary, of course, also has rights in personam against the trustee.

BOGERT & BOGERT, *supra* note 97, § 183 (footnotes omitted). For a discussion of statutes in a number of states under which interests in real property held in trust are held entirely by the trustee with the beneficiary having no estate or interest in the trust's real property, see *id.* § 184 (concluding that "[m]ost of the decisions either contradict these statutes by holding that the beneficiary does have some kind of an estate or interest in the trust property, or the cases could have been decided as they were decided without any dependence on the statutes in question."). In Louisiana, however, recent cases have held that a trust beneficiary has no ownership interest in trust property. *See* Read v. United States, 169 F.3d 243 (5th Cir. 1999); David v. Katz, 83 F. Supp. 2d 736 (E.D. La. 2000).

[191] UNIF. TRUST CODE § 814(a) (amended 2005), 7C U.L.A. 307 (Supp. 2005). Prior to the 2005 amendments, the UTC's mandatory rules precluded the settlor from overriding "the duty of a trustee to act in good faith and in accordance with the purposes of the trust." UNIF. TRUST CODE § 105(b)(2) (2004), 7C U.L.A 200 (Supp. 2005) (amended 2005). Because provisions of the UTC other than its mandatory rules do not apply if the settlor provides otherwise in the terms of the trust, section 105(b)(2) raised the question of whether the settlor could waive the section 814(a) requirements that the trustee exercise its discretion in accordance with the terms of the trust and the interests of the beneficiaries. *See* UNIF. TRUST CODE § 105(a) (amended 2005), 7C U.L.A. 200 (Supp. 2005). The 2005 amendments addressed this question by amending section 105(b)(2), which now tracks the language of section 814(a), making its standard of conduct for a trustee of a discretionary trust mandatory. *See id.* § 105(b)(2).

1. At Common Law, Can a Settlor Literally Give the Trustee Unlimited Discretion?

No. As stated in the Second Restatement:

> It is against public policy to permit the settlor to relieve the trustee of all accountability. It is true that the powers conferred upon the transferee of property may be so extensive as to indicate an intention not to create a trust but to give the beneficial interest in the property to the transferee. If, however, a trust is created, it is required by public policy that the trustee should be answerable to the courts, so far at least as the honesty of his conduct is concerned.[192]

2. Under Non-UTC Law, If the Settlor Purports to Give the Trustee Absolute or Uncontrolled Discretion, Under What Circumstances Will a Court Nevertheless Review the Trustee's Exercise of Its Discretion?

The common law provides no single, universally accepted statement of the minimum standard of conduct required of the trustee to avoid judicial interference when the terms of the trust purport to give the trustee unlimited discretion.[193] Rather, cases, treatises, restatements, and commentators' analyses use different language to describe the standard the trustee will be held to regardless of the extent of discretion the settlor grants the trustee.[194] Such different language likely does not reflect substantively

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[192] RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. k (1959) (Citations omitted). *See also* Stix v. Comm'r, 152 F.2d 562, 563 (2d Cir. 1945); Estate of Ralston, 37 P.2d 76 (Cal. 1934); McNeil v. McNeil, 798 A.2d 503, 509 (Del. 2002); Ponzelino v. Ponzelino, 26 N.W.2d 330 (Iowa 1947); Keating v. Keating, 165 N.W. 74 (Iowa 1917); John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1120, 1124 (2004).

[193] *See generally* BOGERT & BOGERT, *supra* note 97, § 560 (Supp. 2004). If the terms of the trust do not include extended discretion language, such as "absolute," "sole," or "uncontrolled," under the Second Restatement the trustee's exercise of its discretion will not be disturbed unless the trustee "acts dishonestly, or with an improper . . . motive, or fails to use his judgment, or acts beyond the bounds of a reasonable judgment." RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. e (1959).

[194] In Colorado, for example, the Supreme Court, en banc, citing and quoting from 2A SCOTT & FRATCHER, *supra* note 3, § 128.3, found that: "*If the settlor manifested an intention that the discretion of the trustee should be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment.*" *In re* Marriage of Jones, 812 P.2d 1152, 1156 (Colo. 1991). By contrast, according to the court in a recent Florida case: "Although the trustee of the trust in the instant appeal has

different standards.[195]

For example, the same subsection of Professor Scott's treatise describes in different ways the limits on the discretion of a trustee, who is relieved by the settlor of the otherwise applicable requirement to exercise its discretion reasonably.[196] First, it provides that the trustee may act "beyond the bounds of a reasonable judgment, *if he acts in good faith and does not act capriciously.*"[197] Second, it provides that if, "by the terms of the trust [the trustee] is not required to act reasonably, the court will interfere *where he acts dishonestly or in bad faith, or where he acts from an improper motive.*"[198] There is no mention that these standards are substantively different. Furthermore, a different passage of the treatise notes that the trustee's discretion can be enlarged by the use of terms such as "absolute," but that even then "the court will control his action *where he acts in bad faith.* The real question is whether it appears that the trustee is *acting in that state of mind in which it was contemplated by the settlor that he should act.*"[199] As a final illustration, the Third Restatement provides:

> Even under the broadest grant of fiduciary discretion, a trustee must act *honestly and in a state of mind contemplated by the settlor.* Thus, the court will not permit the trustee *to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power.*[200]

3. Is the Requirement of Subsection 814(a) That the Trustee Act In Good Faith, Regardless Of the Extent of Discretion the Settlor Grants the Trustee, a Change From the Common Law?[201]

No. Cases from many jurisdictions explicitly acknowledge the require-

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absolute discretion to pay out income and principal to the beneficiaries, he still must exercise good faith and be judicious in the administration of the trust." Friedman v. Friedman, 844 So. 2d 789, 792 (Fl. Dist. Ct. App. 2003).

[195] As discussed *infra* at notes 222-31 and accompanying text, the primary issue of the effect of extended discretion language is whether it relieves the trustee of the otherwise applicable obligation to exercise its discretion in an objectively reasonable manner.

[196] *See* 2A SCOTT & FRATCHER, *supra* note 3, § 187.2.

[197] *Id.* (emphasis added) (footnote omitted).

[198] *Id.* (emphasis added) (footnotes omitted).

[199] *Id.* § 187 (emphasis added) (footnote omitted). *See also The Uniform Trust Code—Part I*, 2003 PRAC. DRAFTING, 7420, 7439 (observing that section 187 "preserv[es] *the requirement of good faith*") (emphasis added).

[200] RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (2003) (emphasis added).

[201] For an argument to that effect, see Merric & Oshins, *supra* note 1, at 482.

ment that trustees exercise discretion in good faith even if the trustee is granted extended discretion.[202] Many other cases, however, do not explicitly acknowledge the trustee's duty to act in good faith, but instead provide that the trustee's exercise of its discretion will not be disturbed absent one or more of factors such as bad faith, dishonesty, an improper motive, or a failure to use the trustee's judgment.[203] The fact that these cases do not explicitly state that trustees must act in good faith, regardless of the breadth of their discretion, however, does not mean that the courts that decided them do not require good faith of the trustee.[204]

Rather, requiring that the trustee not act in bad faith, or dishonestly, or with an improper motive, or fail to act altogether is another way of expressing the fundamental fiduciary requirement that the trustee must act in good faith (or implicitly includes that requirement).[205] There is much evidence that is the case. For example, a court in a 1953 California case addressed the judicial review of a trustee's exercise of discretion and found that if:

> the "sole discretion" vested in and exercised by the trustees in this case . . . were exercised fraudulently, in bad faith or in an abuse of discretion, it is subject to . . . review. Whether good faith has been exercised, or whether fraud, bad faith or an abuse of discretion has

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[202] *See, e.g., Friedman*, 844 So. 2d 789; Jacob v. Davis, 738 A.2d 904 (Md. Ct. Spec. App. 1999); *O'Shaughnessy*, 517 N.W.2d 574; *In re* Estate of Mayer, 672 N.Y.S.2d 998 (N.Y. Sur. Ct. 1998); *In re* Ternansky's Estate, 141 N.E.2d 189 (Ohio Ct. App. 1957); NationsBank of Virginia, N.A. v. Estate of Grandy, 450 S.E.2d 140 (Va. 1994).

[203] *See, e.g., Marriage of Jones*, 812 P.2d 1152; Goodwine v. Goodwine, 819 N.E.2d 824 (Ind. Ct. App. 2004); Jennings v. Murdock, 553 P.2d 846 (Kan. 1976); Am. Cancer Soc'y, St. Louis Div. v. Hammerstein, 631 S.W.2d 858 (Mo. Ct. App. 1981); *In re* Goodman, 790 N.Y.S.2d 837 (N.Y. Sur. Ct. 2005); Finch v. Wachovia Bank & Trust Co., N.A., 577 S.E.2d 306 (N.C. Ct. App. 2003); Robinson v. Kirbie, 793 P.2d 315 (Okla. Civ. App. 1990).

[204] Professor Bogert's treatise explains that two standards are used by courts in determining whether and to what extent they will review a trustee's exercise of absolute and uncontrolled discretion. BOGERT & BOGERT, *supra* note 97, § 560 (Supp. 2004). Under the first, judicial review occurs when the trustee acts in bad faith, dishonestly, or from a motive other than the accomplishment of the purposes of the trust. *Id.* Under the second, the trustee must also act reasonably. *Id.* In discussing the two standards, the treatise notes, "There is agreement that a trustee must act in good faith . . ." *Id.*

[205] As amended in 2005, the comment to section 814 provides: "The obligation of a trustee to act in good faith is a fundamental concept of fiduciary law although there are different ways that it can be expressed." UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 308 (Supp. 2005).

> been committed is always subject to consideration by the court upon appropriate allegations and proof.[206]

More recently, California adopted a statute that provides, "If a trust instrument confers 'absolute,' 'sole' or 'uncontrolled' discretion on a trustee, the trustee shall act in accordance with fiduciary principles and shall not act in bad faith or in disregard of the purposes of the trust."[207] A California court referring to that statute noted, "It is presumed that the trustee will act in good faith to effectuate the settlor's intent."[208] Moreover, in an Indiana case (involving a trustee who was not granted extended discretion) in which the court noted that "[t]he trust relationship involves the exercise of the utmost good faith on the part of the trustees," it also found that "[i]n the absence of bad faith, or an abuse or unreasonable exercise of discretion by the co-trustees," it would not interfere with the trustee's exercise of its discretion.[209]

Further, a year after the Colorado Supreme Court found that where the settlor gives the trustee uncontrolled discretion the court will not interfere with its exercise unless the trustee "acts dishonestly or from an improper motive, or fails to use his judgment,"[210] a lower appellate court in Colo-

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[206] *In re* Ferrall's Estate, 258 P.2d 1009, 1013 (Cal. 1953). A District of Columbia court similarly has equated good faith with the absence of bad faith: "The transfer of the certificate of deposit cannot be deemed self-dealing when it is done in good faith for the benefit of the estate. Since no bad faith by Michele Hagans was shown at trial, the trial judge did not clearly err in approving the transaction." Jones v. Hagans, 634 A.2d 1219, 1225 (D.C. 1993) (citation omitted).

[207] CAL. PROB. CODE § 16081(a) (West 1991 & Supp. 2005).

[208] Ventura County Dep't of Child Support Servs. v. Brown, 11 Cal. Rptr. 3d 489, 499 (Cal. Ct. App. 2004).

[209] *In re* Nathan Trust, 618 N.E.2d 1343, 1346 (Ind. Ct. App. 1993), *vacated, In re* Della Lustgarten Nathan Trust, 638 N.E.2d 789 (Ind. 1994). The court's opinion in a Wisconsin case, in which extended discretion language was not used, addressed judicial review of the trustee's exercise of its discretion similarly:

> So long as trustees act in good faith and from proper motives and within the bounds of a reasonable judgment under the terms and conditions of the trust, the court has no right to interfere. It is only when they act outside the bounds of a reasonable judgment, or are guilty of an abuse of discretion, or when they act dishonestly and improperly that the court may interfere.

In re Filzen's Estate, 31 N.W.2d 520, 522 (Wis. 1948).

[210] *Marriage of Jones*, 812 P.2d at 1156. Note that in *Jones*, the Colorado Supreme Court did not announce a single standard to be applied in Colorado in cases involving a challenge to the trustee's exercise of discretion. In fact, the case did not even involve such a challenge, but instead decided whether a wife's interest in a discretionary trust constituted property for purposes of division in a divorce. *Id.* In holding that it did not, the court de-

rado decided a case in which a trustee with sole and absolute discretion over distributions also was a remainder beneficiary and thus had a conflict of interest in his exercise of discretion.[211] In upholding the income beneficiary's claim for increased distributions from the trust, the Colorado court characterized the trustee's conduct as an abuse of discretion, arbitrary and capricious, improperly motivated, and a "breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward the beneficiary."[212]

Cases from Minnesota also illustrate that use of a test focusing on factors such as the trustee's motive in exercising its discretion does not mean good faith is not required. In Minnesota, the trustee's obligation to exercise its discretion in good faith is explicit,[213] and the test of whether a trustee has abused its discretion looks to, among other things, the trustee's motive and whether the trustee acted with a conflict of interest.[214] Furthermore, a 1931 South Carolina case required trustees to exercise discretion "honestly and faithfully," and found that "[a] plainly arbitrary, unreasonable, or fraudulent exercise" would have been actionable.[215] The opinion did not explicitly require trustees to act in good faith. The following quote, however, is from a relatively recent South Carolina case that summarized the holding in the earlier South Carolina decision:

> [W]here a trust gives a trustee discretionary authority, the trustee cannot exercise such discretion upon a mere whim and without accountability, but the trustee is limited by the primary purpose of the grant, and must act with good faith as to any discretion vested

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scribed the circumstances under which a trustee's exercise of discretion will be reviewed in four different ways: (1) "the beneficiary could not force the trustee to pay income or principal unless she could establish fraud or abuse of discretion"; (2) "[t]he beneficiary cannot obtain the assistance of the court to control the exercise of the trustee's discretion except to prevent an abuse by the trustee of his discretionary power," (3) "*[i]f the settlor manifested an intention that the discretion of the trustee should be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment*"; and (4) "the beneficiary of a discretionary trust has no contractual or enforceable right to income or principal from the trust, and cannot force any action by the trustee unless the trustee performs dishonestly or does not act at all." *Id.*

[211] *See In re* Estate of McCart, 847 P.2d 184 (Colo. Ct. App. 1992).

[212] *Id.* at 186.

[213] *See, e.g., O'Shaughnessy*, 517 N.W.2d 574; Norwest Bank Minn. N., N.A. v. Beckler, 663 N.W.2d 571 (Minn. Ct. App. 2003).

[214] *See In re* Trusts A & B of Divine, 672 N.W.2d 912 (Minn. Ct. App. 2001).

[215] Lynch v. Lynch, 159 S.E. 26, 31 (S.C. 1931).

> in him. Moreover, discretion vested in a trustee must be honestly and faithfully exercised.[216]

Finally, in a Virginia case in which the court noted that the trustees had "uncontrolled judgment and discretion" over distributions, it described the circumstances under which the exercise of that discretion would be subject to judicial review as follows:

> Generally, a trustee's discretion is broadly construed, but his actions must be an exercise of good faith and reasonable judgment to promote the trust's purpose. A trustee's exercise of discretion should not be overruled by a court unless the trustee has clearly abused the discretion granted him under the trust instrument or acted arbitrarily in such a way as to destroy the trust he is to maintain.[217]

4. Are There Any Cases in Which a Court Has Found That the Use of Extended Discretion Language Waives the Trustee's Obligation to Act in Good Faith?

Yes, there is at least one. According to dictum from an intermediate appellate court in Tennessee, the settlor may waive the requirement that the trustee act in good faith, apparently by describing the trustee's discretion with terms such as "absolute," "unlimited," or "uncontrolled."[218] That dictum, however, appears to be based on the court's mistaken treatment of the trustee's obligation to act in good faith as the obligation to act reasonably: "The good faith requirement may be waived by the words of the trust but the words are interpreted narrowly. Words found to waive the reasonableness standard are 'absolute' or 'unlimited' or 'uncontrolled' discretion."[219] Requiring a trustee to act in good faith, however, is not the same as requiring it to act reasonably.[220] As noted in Professor Scott's treatise, if the settlor relieves the trustee from the duty to act reasonably, the courts

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[216] Sarlin v. Sarlin, 430 S.E.2d 530, 532-33 (S.C. Ct. App. 1993).

[217] *Grandy*, 450 S.E.2d at 143.

[218] *See* Krug v. Krug, 838 S.W.2d 197, 201 (Tenn. Ct. App. 1992) (dictum). In *Krug*, a trustee was given the "sole discretion" to remove and replace a cotrustee; the court held that the language was not sufficient to waive the trustee's obligation to act in good faith. *Id.*

[219] *Id.*

[220] In reviewing the exercise of the trustee's discretion in an Oregon case, the court stated: "There is no question of the trustee's good faith in making his decision to limit the payments as he did. The only question presented is the reasonableness of his judgment." Rowe v. Rowe, 347 P.2d 968, 974 (Or. 1959).

will not interfere with the trustee's exercise of discretion "if he acts in good faith and does not act capriciously."[221]

5. Does Subsection 814(a) Impose a Reasonableness Requirement On the Trustee's Exercise of Discretion?

Generally, if a standard by which the reasonableness of the trustee's exercise of discretion can be tested is included in the instrument, reasonableness is required.[222] If the terms of the trust do not include a standard, the Second Restatement implies that reasonableness therefore is not required.[223] Further, under the Second Restatement, even if the terms of the trust include a standard against which the reasonableness of the trustee's exercise of its discretion can be judged, the trustee will not be required to exercise it reasonably if the settlor provides otherwise in the terms of the trust.[224] The settlor may provide otherwise by using terms such as "absolute," "unlimited," or "uncontrolled" in describing the trustee's discretion.[225]

Whether these rules of the Second Restatement apply under the UTC is not clear. Subsection 814(a) itself does not address the issue. As amended in 2005, the comment to section 814 provides, in part:

> Subsection (a) requires a trustee exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to Restatement (Second) of Trusts Section 187 (1959), subsection (a) does not impose an obligation that a trustee's decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee's judgment can be tested. Restatement (Second) of Trusts Section 187 cmt. f (1959).[226]

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[221] 2A SCOTT & FRATCHER, *supra* note 3, § 187.2. *See also* JESSE DUKEMINIER ET AL., WILLS, TRUSTS, AND ESTATES 540-41 (7th ed. 2005).

[222] *See* RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. i (1959).

[223] *See id.* "In such a case, however, the court will interpose if the trustee acts dishonestly, or from some improper motive." *Id.*

[224] *See id.*

[225] *Id.* cmt. j.

[226] UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 308 (Supp. 2005). (Note that the citation to comment f to section 187 of the Second Restatement apparently should be to comment i to section 187.)

This comment, with its references to the Second Restatement, arguably indicates that the Second Restatement's treatment of the reasonableness issue applies under subsection 814(a). However, the comment does not address the effect of extended discretion language on the trustee's obligation to exercise its discretion reasonably, nor does it cite the Second Restatement provision[227] that does so. Further, as discussed next, some jurisdictions require reasonableness of the trustee in the exercise of its discretion even if the instrument uses extended discretion language. Thus, by not addressing the issue, the UTC may be leaving its resolution to the common law and principles of equity of enacting jurisdictions.[228]

6. Under Non-UTC Law, Is a Trustee Whose Discretion Is Described With Terms Such as "Absolute," "Sole," or "Uncontrolled" Required to Exercise It Reasonably?

As discussed in the answer to the preceding question, under the Second Restatement the use of such language precludes a court from reviewing a discretionary decision of a trustee for reasonableness.[229] After a lengthy review of the cases on the subject, however, Professor Bogert's treatise concluded, "The authorities do not appear to support the Restatement position that there is no requirement of reasonableness in the exercise of a power granted in the trustee's absolute discretion."[230] Rather:

> In addition to the commonly recognized factors used to determine whether there had been an abuse of discretion, a standard of reasonableness has been applied by the courts in judging the exercise of a discretionary power (whether simple or absolute), a standard implied from the settlor's intent and the purposes expressed in the trust instrument. With respect to court review of discretionary powers, this standard is consistent with the standard of care and

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[227] *See* RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. j (1959).

[228] *See* UNIF. TRUST CODE § 106 (amended 2005), 7C U.L.A. 204 (Supp. 2005). For a proposal that the UTC's comment to § 814(a) be modified or clarified and that trustees be required to exercise discretion reasonably, without regard to the breadth of their discretion, see Danforth, *supra* note 1.

[229] The Third Restatement's discussion of this subject notes that many cases cite the Second Restatement rule that use of extended discretion language dispenses with the reasonableness standard, but observes: "Cases, however, are difficult to find, involving extended discretion relating to distribution of income or principal, in which courts have approved what actually appears to be unreasonable conduct." RESTATEMENT (THIRD) OF TRUSTS, Reporter's Notes on § 60 cmt. c, at 288 (2003).

[230] BOGERT & BOGERT, *supra* note 97, § 560.

skill of a prudent man and is based upon established fiduciary standards and principles.[231]

7. *Does the Language in Subsection 814(a) That Requires the Trustee Not Only to Act in Good Faith, But Also to Exercise Its Discretion "In Accordance With the Terms and Purposes of the Trust and the Interests of the Beneficiaries"[232] Expand the Scope of Judicial Review of a Trustee's Exercise of Extended Discretion?*

According to a recent argument to that effect:

> Section 814(a) illustrates the uncertainty that codifying the trust law may create. What do the words "and in accordance with the terms and purposes of the trust and the interests of the beneficiaries" mean? Do they create a stricter limit on the discretion that may be conferred upon a trustee than the common law test set forth in the above quotation from Scott? It seems likely that courts will use them to do so in particular cases, yet their application to particular facts remains as hard to predict as that of the common law. Has anything been gained by codification?[233]

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[231] *Id.* at 32 (Supp. 2004) (footnotes omitted). The analysis of Professors Dukeminier, Johanson, Lindgren, and Sitkoff reaches a similar conclusion:

> What, then, are the limitations on the trustee's freedom when the trustee has "absolute and uncontrolled discretion"? Professor Scott argued for a subjective standard, emphasizing the trustee's "good faith" and proper motives and dispensing with the requirement of reasonableness. He suggested, and the Restatement for which he was the reporter adopted, a standard of whether the trustee has acted "in that state of mind in which it was contemplated by the settlor that he should act." Scott, supra, at 16; Restatement (Second) of Trusts § 187, cmt. j (1959). Some courts, relying on the Restatement's good faith standard, declare that the trustee must not act arbitrarily or capriciously, seemingly bringing in a reasonableness test under the guise of other words. Other courts apply a reasonableness test even when the discretion is "absolute."
>
> In the final analysis, it appears that the difference between simple discretion and "absolute" discretion is one of degree and that the trustee's action must not only be in good faith but also to some extent reasonable, with more elasticity in the concept of reasonableness the greater the discretion given.

DUKEMINIER ET AL., *supra* note 221, at 540-41.

[232] Note that "interests of the beneficiaries" is a defined term under the UTC. *See* UNIF. TRUST CODE § 103(8) (amended 2005), 7C U.L.A. 192 (Supp. 2005). It does not mean what the beneficiaries assert or the court determines to be in the beneficiaries' best interests. Rather, "interests of the beneficiaries" means "the beneficial interests provided in the terms of the trust." *Id.*

[233] *The Uniform Trust Code—Part I*, *supra* note 199, at 7440 (footnote added). The

Subsection 814(a)'s requirement that the trustee exercise even extended discretion in accordance with the terms and purposes of the trust and the interests of the beneficiaries, however, is not new. Rather, it simply reflects the trustee's basic obligation with respect to the administration of the trust.[234]

The Second Restatement expressly addresses the trustee's obligation to exercise its discretion in administering a trust in accordance with the purposes of the trust: even a trustee with "absolute," "unlimited," or "uncontrolled" discretion may not exercise it "from some motive other than the accomplishment of the purposes of the trust."[235] In a New York case, a testator who made substantial pre-residuary charitable gifts left the residue of his estate in trust for his wife's benefit, and referred to his "'paramount intention and wish that (my) wife shall have anything that she requires or may desire for her personal welfare and comfort.'"[236] The testator named his wife as the primary income beneficiary of the trust and authorized the trustee to invade principal for her benefit "'in its sole, absolute, and unimpeachable discretion.'"[237] In rejecting the widow's request for a principal distribution to make a charitable gift in memory of the testator, which the trustee was willing to grant, the court found that allowing the

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"above quotation from Scott" referred to is:

> The extent of the discretion may be enlarged by the use of qualifying adjectives or phrases such as "absolute" or "uncontrolled." Even the use of such terms, however, does not give him unlimited discretion. A good deal depends upon whether there is any standard by which the trustee's conduct can be judged. Thus if he is directed to pay as much of the income and principal as is necessary for the support of a beneficiary, he can be compelled to pay at least the minimum amount which in the opinion of a reasonable man would be necessary. If, on the other hand, he is to pay a part of the principal to a beneficiary entitled to the income, if in his discretion he should deem it wise, the trustee's decision would normally be final, although as will be seen the court will control his action where he acts in bad faith. The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he should act.

The Uniform Trust Code—Part I, *supra* note 199, at 7439 (quoting 2A SCOTT & FRATCHER, *supra* note 3, § 187).

[234] The comment to section 814 addresses this language by noting that: "Consistent with the trustee's duty to administer the trust (*see* section 801), the trustee's exercise must also be in accordance with the terms and purposes of the trust and the interests of the beneficiaries." UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 307 (Supp. 2005).

[235] RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. j (1959).

[236] *In re* May's Estate, 112 N.Y.S.2d 847, 848 (N.Y. Sur. Ct. 1952).

[237] *Id.*

distribution "would constitute a departure from the testamentary program fixed by the deceased."[238] Many other cases from many jurisdictions support subsection 814(a)'s requirement that the trustee exercise even extended discretion in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[239]

C. What, Then, is the Effect of the UTC On the Rights of Trust Beneficiaries and the Duties of Trustees For Discretionary Distributions?

Subsection 814(a)'s formulation of the minimum standard of conduct required even of a trustee that is granted extended discretion codifies the common law and should not change the traditional analysis of whether a beneficiary of a given trust in a given situation is entitled to receive a distribution. After discussing subsection 814(a)'s requirement that trustees act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, the comment to section 814, as amended in 2005, explicitly notes that it "does not otherwise address the obligations of a trustee to make distributions, leaving that issue to the caselaw."[240] Further, the UTC's elimination of the distinction between discretionary and support trusts[241] is in the context of rights of creditors of beneficiaries and "does not affect the rights of a beneficiary to compel a distribution."[242] Given that subsection 814(a) codifies the common law standards applicable to trustees in the exercise of discretionary powers and that the UTC explicitly provides that neither subsection 814(a) nor Article 5's elimination of the distinction between discretionary and support trusts affects distribution rights and duties, the UTC should not affect the rights and duties of beneficiaries and trustees for discretionary distributions.

VIII. SUBSECTION 814(a): IS THERE A BETTER ALTERNATIVE?

Many of the criticisms directed at the UTC's creditors' rights provisions are based, to a significant extent, on the argument that beneficiaries

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[238] *Id.* at 849.

[239] *See, e.g.*, Conway v. Enemy, 96 A.2d 221 (Conn. 1953); Conn. Bank & Trust Co. v. Hartford Hosp., 276 A.2d 792 (Conn. Super. Ct. 1971); *In re* Murray, 45 A.2d 636 (Me. 1946); Fine v. Cohen, 623 N.E.2d 1134, 1139 (Mass. App. Ct. 1993); *O'Shaughnessy*, 517 N.W.2d 574; *Hammerstein*, 631 S.W.2d 858; Taylor v. McClave, 15 A.2d 213 (N.J. Ch. 1940); *In re* Estate of Mayer, 672 N.Y.S.2d 998; *In re* Hansen's Estate, 23 A.2d 886 (Pa. 1942). *See also* MONT. CODE ANN. § 72-34-130 (2005).

[240] UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 307 (Supp. 2005).

[241] *See supra* Section VI.

[242] UNIF. TRUST CODE § 504 cmt. (amended 2005), 7C U.L.A. 256 (Supp. 2005).

of discretionary trusts have enforceable rights under the UTC that are greater than they have under non-UTC trust law.[243] That argument, in turn, is largely based on the claim that the standard of conduct required of a trustee in the exercise of its discretion under subsection 814(a) provides beneficiaries with significantly greater rights to compel discretionary distributions than they otherwise would have.[244] This Article argues that subsection 814(a)'s statement of the standard to which trustees will be held in their exercise of discretionary powers, regardless of the breadth of discretion the settlor grants, does not effect a change in the common law, but is a codification of the traditional common law standard that is expressed differently in some jurisdictions.[245]

If subsection 814(a) is simply one of multiple ways of expressing the traditional, common law standard to which trustees with discretionary powers are held, though, the question is raised whether a UTC-enacting jurisdiction could substitute for subsection 814(a) an alternative formulation of the standard without effecting a substantive change. Again, subsection 814(a) provides:

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute", "sole", or "uncontrolled", the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[246]

An alternative standard, derived from a Colorado case,[247] is that if the trustee is granted extended discretion, through the use of language such as "sole and absolute," the court will interfere with its exercise only if the trustee (1) acts dishonestly, (2) acts with an improper motive, or (3) fails to use his or her judgment.[248] This standard has been described by its proponents as a "bad faith" standard.[249]

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[243] *See, e.g.*, Merric & Oshins, *supra* note 1, at 481.

[244] *Id.*

[245] *See supra* Section VII.

[246] UNIF. TRUST CODE § 814(a) (amended 2005), 7C U.L.A. 307 (amended 2005).

[247] *Marriage of Jones*, 812 P.2d at 1156 (quoting 2A SCOTT & FRATCHER, *supra* note 3, § 128.3). Note, however, that *Jones* did not even involve a challenge to a trustee's exercise of discretion and actually expressed the circumstances under which the trustee's exercise of its uncontrolled discretion would be reviewed in four different ways. *See supra* note 210.

[248] *See* Merric & Oshins, *supra* note 1, at 479.

[249] *Id.*

Fundamental to the duties of a trustee is that it administer the trust in accordance with the trust's terms to carry out the intention of the settlor. If a trustee makes a discretionary distribution that is not permitted by the terms of the trust, it has breached its duty, regardless of the breadth of its discretion, even if it (1) did not act dishonestly, (2) was motivated by a desire to act in the best interests of the beneficiary, and (3) exercised its judgment in making its discretionary decision. For example, if the instrument grants the trustee the "sole, absolute, and uncontrolled" discretion to make distributions for a beneficiary's support for life, remainder to other beneficiaries, a trustee who makes a distribution to the current beneficiary to meet a non-support related emergency need has breached its duty to administer the trust in accordance with its terms. (Such a breach also could be described as a failure to administer the trust in accordance with the interests of the beneficiaries, as defined in the instrument, because the distribution effectively would have shifted trust benefits to the distributee beneficiary and away from other beneficiaries. Alternatively, the breach also could be characterized as a failure to administer the trust in accordance with the settlor's purposes of providing for the support of the current beneficiary and otherwise preserving the trust assets for successive beneficiaries.)

Arguably, the bad faith standard described above would cover this type of breach through its requirement that a trustee not act with an improper motive, as the distribution would have been motivated by a desire to further a purpose the settlor had not intended for the trust. If the trustee, however, was motivated by the desire to benefit the beneficiary—perhaps in a way the trustee believes the settlor would have done if the settlor were living—labeling the conduct as improperly motivated is more problematic than simply finding it to be impermissible as not in accordance with the trust's terms, its purposes, or the interests of its beneficiaries.

Again, if a trustee with absolute and uncontrolled discretion exercises its judgment, acts honestly, and is not improperly motivated, it nevertheless will have breached its duty if it misconstrues the instrument and makes a discretionary distribution or engages in other conduct in administering the trust that is not permitted by the trust's terms. To further illustrate, if the trust's beneficiaries are the settlor's descendants and a child of the settlor has adopted an adult, the adoptee may or may not be a "descendant" of the settlor within the meaning of the trust instrument.[250] If not, a

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[250] In some states, an adopted individual is not treated as the child of the adopting parent, for purposes of construing another's trust instrument, unless the adopted person lived

trustee who exercises its discretion to make distributions to the adoptee has breached its duty without regard to the breadth of its discretion, its honesty, its motive, or its exercise of its judgment.[251] Accordingly, if a jurisdiction prefers the bad faith standard to requiring affirmatively that trustees must act in good faith, it should build language into the bad faith standard similar to that of subsection 814(a), which requires trustees to administer trusts in accordance with their terms and purposes and the interests of the beneficiaries.[252]

As for the issue of whether, in addition to requiring trustees to exercise discretion in accordance with the terms and purposes of the trust and the interests of the beneficiaries, the standard is best stated as requiring good faith or prohibiting bad faith, there is much evidence that courts (and commentators) do not distinguish between the two, but use the terms interchangeably.[253] From that perspective, little may be lost in using a bad faith, rather than a good faith, standard. However, because the very nature of the fiduciary relationship between a trustee and beneficiary requires, at a minimum, that the trustee act in good faith in administering the trust,[254]

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while a minor as a regular member of the adopting parent's household. *See, e.g.*, UNIF. PROBATE CODE § 2-705(c) (amended 1993), 8 U.L.A. 188 (1998). Similarly, even a birth child who has not been adopted by another may not be considered as a child of the natural parent for purposes of construing another's trust instrument, if the child did not live while a minor as a regular member of the natural parent's household. *See, e.g., id.* § 2-705(b).

[251] For cases holding that trustees with extended discretion must administer their trusts in accordance with the settlor's purposes and the trust's terms, see *supra* notes 236, 239.

[252] A Missouri case is illustrative of combining a bad faith standard with an obligation that a trustee exercise its discretion in accordance with the terms and purposes of the trust and the interests of the beneficiaries. The court reviewed the trustee's exercise of discretion to terminate a trust and found the Missouri bad faith test applies when the trust's terms do not include an objective standard against which the trustee's conduct can be judged:

> When a testator vests sole discretion in a matter in the trustee and supplies no objective standards by which to evaluate the reasonableness of his conduct, a court must not interfere unless the trustee, in exercising his power, wilfully abuses his discretion or acts arbitrarily, fraudulently, dishonestly or with an improper motive.

Hammerstein, 631 S.W.2d at 863. However, the opinion also notes, "Certainly, a grant of absolute discretion to a trustee is not a roving commission—the trustee must be guided by the interest of the beneficiary and must further trust purposes in the exercise of his power." *Id.* at 864.

[253] *See supra* notes 193-217 and accompanying text.

[254] Judge Cardozo's famous description of the trustee's duty of loyalty is instructive:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the

the preferable alternative is simply to say so.[255]

IX. THE UTC, SPECIAL AND SUPPLEMENTAL NEEDS TRUSTS, AND PUBLIC BENEFITS

Some UTC critics have argued that it will have a negative impact on beneficiaries of special and supplemental needs trusts ("SNTs").[256] This Section discusses some of the principal reasons why that is not the case.[257]

A. What Is the Difference Between a "Special Needs Trust" and a "Supplemental Needs Trust"?

Both refer to trusts intended to allow their beneficiaries to receive benefits from the trust without disqualifying them from also receiving public assistance for their support. While the terms are sometimes used interchangeably, many refer to trusts that are funded with the beneficiary's

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punctilio of an honor the most sensitive, is then the standard of behavior.

Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). While Judge Cardozo was addressing the duty of loyalty, rather than the trustee's obligation to exercise extended discretion, the principle he describes is difficult to reconcile with the position that a trustee need not act in good faith, as long as it does not act in bad faith.

For a sampling of cases that involved fiduciary relationships other than a trustee and beneficiary that acknowledge the fundamental obligation of a fiduciary to act in good faith, see Burch v. Argus Props., Inc., 154 Cal. Rptr. 485, 487 (Cal. Ct. App. 1979) (real estate broker and principal); Johnson v. Provena St. Therese Med. Ctr., 778 N.E.2d 298 (Ill. App. Ct. 2002) (personal representative and beneficiaries of an estate); Paul v. North, 380 P.2d 421, 428 (Kan. 1963) (parties who, by their concerted action, willingly and knowingly act for one another in a manner as to impose mutual trust and confidence); Hoopes v. Hammargren, 725 P.2d 238, 242 (Nev. 1986) (physician and patient); Gedeon v. State Farm Mut. Auto. Ins. Co., 188 A.2d 320, 322 (Pa. 1963) (insurer defending claims against an insured); Moore v. Moore, 599 S.E.2d 467, 472 (S.C. Ct. App. 2004) (partners). Note also that good faith is required even in arm's length business dealings when the parties are not in a fiduciary relationship, see, e.g., Sheltry v. Unum Life Ins. Co. of Am., 247 F. Supp. 2d 169 (D. Conn. 2003), and is referenced in at least 50 different provisions of the Uniform Commercial Code. *See* Tory A. Wiegand, *The Duty of Good Faith and Fair Dealing in Commercial Contracts in Massachusetts*, 88 MASS. L. REV. 174, 178 (2004).

[255] As discussed *supra* at note 202 and accompanying text, many courts have expressly done just that.

[256] *See, e.g.*, Mark Merric & Douglas W. Stein, *A Threat to all SNTs*, TR. & EST. Nov. 2004, at 38.

[257] For more detailed analyses of the UTC and SNTs, see Richard E. Davis & Stanley C. Kent, *The Impact of the Uniform Trust Code on Special Needs Trusts*, 1 NAELA J. 235 (2005); Richard E. Davis & Stanley C. Kent, *The Uniform Trust Code and Supplemental Needs Trusts*, 15 PROB. L.J. OF OHIO 53, 53 (2005) [hereinafter Davis & Kent, UTC & SNTs]. *See also* Richard E. Davis, *UTC is No Threat to SNTs*, TR. & EST. 12 (Jan. 2005).

own assets, including those to which the beneficiary is entitled under a personal injury award, as "special needs trusts," and to trusts that are funded by third parties for a disabled beneficiary as "supplemental needs trusts."[258] The eligibility rules vary considerably for SNTs funded with a person's own assets and for those funded with assets of a third party.

B. Will the UTC Adversely Affect the Ability of Beneficiaries of Self-settled SNTs to Qualify for Public Benefits?

No. Generally, under the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993"), trusts that meet OBRA 1993's requirements may be used by disabled persons to hold their own assets for their benefit, without disqualifying them from receiving public benefits.[259] The most common OBRA 1993 trust is the "pay-back" or "(d)(4)(A)" trust,[260] the terms of which require the state to be repaid from the remaining trust assets at the beneficiary's death an amount equal to the Medicaid benefits that were paid for the beneficiary's medical care.[261] Under OBRA 1993, the assets in a trust are "insulated . . . from consideration by the Medicaid program so that public entitlement for medical care remains available to them."[262] The UTC will have no effect on that federally mandated result.[263]

C. Will the UTC Adversely Affect the Ability of Beneficiaries of Third-party Created SNTs to Qualify For Public Benefits?

No. Generally, public assistance for purposes such as medical and institutionalized care is limited to the needy, with consideration in determining eligibility given both to a person's income and resources.[264] If the

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[258] *See, e.g.*, Ian S. Oppenheim, *Guest Editor's Message*, NAELA QUARTERLY, Summer 2001, at 2, 3.

[259] *See* Omnibus Budget Reconciliation Act of 1993, 42 U.S.C. § 1396p (2000). *See generally* KRUSE, *supra* note 162, at 11-13.

[260] *See* 42 U.S.C. § 1396p(d)(4)(A).

[261] *See* KRUSE, *supra* note 162, at 12.

[262] *Id.* at 11.

[263] *See* Davis & Kent, UTC & SNTs, *supra* note 257, at 55-56.

[264] For an overview of Medicaid, the most significant source of public benefits for medical and institutionalized care of the needy, see Centers for Medicare & Medicaid Services, United States Department of Health and Human Services, *Medicaid: A Brief Summary*, http://www.cms.hhs.gov/publications/overview-medicare-medicaid/default4.asp (last visited Nov. 2, 2005). *See also* Molly Mead Wood, *Medicaid Eligibility for Long-Term Care: The Basics*, 16 PREVENTIVE L. REP. 8, Summer 1997, at 8 (Featuring 2003 updates); Barbara J. Collins, *Medicaid Eligibility and Coverage for Elderly and Disabled Clients: Overview and Update*, 12TH ANN. ELDER L. INST. REPRESENTING THE ELDERLY CLIENT OF

assets of an SNT are treated as available to the beneficiary, the beneficiary likely will not meet the resources test for public benefits qualification.[265] "Available" for this purpose means "actually available."[266] Many cases have held that whether the assets of a third-party created trust are actually available to the beneficiary depends on whether the beneficiary may compel distributions for support.[267] While cases often explain that the assets of support trusts are disqualifying available resources while those of discretionary trusts are not,[268] the underlying rationale for making that classification determinative of whether the trust assets are actually available to the beneficiary is that the beneficiary may compel distributions for support from a support trust but not from a discretionary trust.[269] While the UTC does not classify trusts as "support" or "discretionary,"[270] it does not change existing law on the question of whether a beneficiary of a third-party created trust may compel a distribution[271] and thus does not affect whether the trust assets will be disqualifying available resources for public benefits eligibility purposes.

Third-party created trusts that raise public benefits qualification issues take at least three forms: (1) the dispositive provisions specifically preclude the trustee from providing for the beneficiary's basic support, but instead authorize the trustee to provide for the beneficiary's supplemental

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MODEST MEANS 39, 41 (2000).

[265] The limit on non-exempt assets a Medicaid recipient may have varies from state to state, but typically is $2,000 for an individual and $3,000 for a couple. LAWRENCE A. FROLIK & ALISON MCCHRYSTAL BARNES, ELDER LAW CASES AND MATERIALS 335 (3d ed. 2003). Exempt assets include a home, household items and personal effects, a car (subject to limitations), a burial plot and limited burial fund, and nominal life insurance policies. *Id.*

[266] *See* 42 U.S.C. § 1396a(a)(17)(B) (2000); 20 C.F.R. §§ 416.120(c)(3), 416.1201(a)(1) (2005); Department of Human Services and Programs Operation Manual System 01120.000. *See also* KRUSE, *supra* note 162, at 52-54; *Corcoran*, 859 A.2d 533; Linser v. Office of Attorney Gen., 672 N.W.2d 643, 646 (N.D. 2003).

[267] *See, e.g., Corcoran*, 859 A.2d 533; Tidrow v. Dir., Mo. State Div. of Family Servs., 688 S.W.2d 9 (Mo. Ct. App. 1985); Metz v. Ohio Dep't of Human Servs., 762 N.E.2d 1032, 1039 (Ohio Ct. App. 2001). *See also* KRUSE, *supra* note 162, at 54 ("To the extent that trust income, resources, or both are limited in terms of beneficiaries' access to them, such income and trust resources are unavailable to the trusts' beneficiaries and are improperly considered by the state agencies charged with administering public entitlement funds.").

[268] *See, e.g., In re* Horton, 668 N.W.2d 208 (Minn. Ct. App. 2003); Eckes v. Richland County Soc. Servs., 621 N.W.2d 851, 855 (N.D. 2001).

[269] *See Eckes*, 621 N.W.2d at 855; *Horton*, 668 N.W.2d at 214.

[270] *See supra* Section VI.

[271] *See supra* Section VII.

needs;[272] (2) the dispositive provisions grant the trustee discretion to provide for the beneficiary's support;[273] and (3) the dispositive provisions grant the trustee discretion to make distributions to or for the benefit of the beneficiary without a support or supplemental needs standard.[274]

For a third-party created trust with terms that explicitly allow distributions only for the beneficiary's supplemental needs, case law is clear and uniform that the assets of the trust will not be considered in determining the beneficiary's eligibility for public benefits.[275] Moreover, some states have codified that result.[276] In short, "Discretionary supplemental care trusts providing for the needs of beneficiaries not supplied by way of public benefit programs, created by nonbeneficiary settlors, appear to be legal, appropriate, and encouraged by both state common law and statutes."[277] For these trusts, the settlor's intent that the trust assets not be used for the beneficiary's support is clear, the beneficiary thus has no right to compel distributions for the beneficiary's support, and the trust's assets therefore are not available disqualifying resources of the beneficiary.[278]

The UTC will have no effect on that result. Its treatment of the duties

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[272] *See, e.g.*, Carnahan v. Ohio Dep't of Human Servs., 743 N.E.2d 473 (Ohio Ct. App. 2000).

[273] *See, e.g., Corcoran*, 859 A.2d 533.

[274] *See, e.g.*, Simpson v. Kan. Dep't of Soc. and Rehab. Servs., 906 P.2d 174 (Kan. Ct. App. 1995). These trusts are often preferred by planners because they provide considerably more flexibility than do trusts that limit distributions to providing for the beneficiary's supplemental needs.

[275] *See* KRUSE, *supra* note 162, at 70-78. An Ohio case, *Young v. Ohio Department of Human Services*, 668 N.E.2d 908 (Ohio 1996), was almost the exception, as three members of the Ohio Supreme Court dissented on the ground that these trusts violate public policy. Contrary to the dissent in *Young*, most courts that have considered the public policy implications of supplemental needs trusts have expressly found that the trusts do not violate public policy. *See, e.g., In re* Leona Carlisle Trust, 498 N.W.2d 260 (Minn. Ct. App. 1993); Hecker v. Stark County Soc. Serv. Bd., 527 N.W.2d 226 (N.D. 1994); *In re* Will of Wright, 107 N.W.2d 146 (Wis. 1961).

[276] *See* KRUSE, *supra* note 162, at 78-82.

[277] *Id. at* 82.

[278] As the Connecticut Supreme Court recently explained,

> [u]nder applicable federal law, only assets *actually available to a medical assistance recipient* may be considered by the state in determining eligibility for public assistance programs such as title XIX [Medicaid] . . . . A state may not, in administering the eligibility requirements of its public assistance program pursuant to title XIX . . . presume the availability of assets not actually available . . . .

Corcoran, 859 A.2d at 545 (quoting Zeoli v. Comm'r of Soc. Servs., 425 A.2d 553 (Conn. 1979)).

and rights of the trustee and beneficiary with respect to discretionary distributions is limited to its codification of the traditional, common law requirement that a trustee exercise its discretion in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[279] It does not otherwise address distribution issues, leaving them to case law.[280] More specifically, a 2005 amendment to the comment to section 814 provides:

> [W]hether the trustee has a duty in a given situation to make a distribution depends on the exact language used, whether the standard grants discretion and its breadth, whether this discretion is coupled with a standard, whether the beneficiary has other available resources, and, more broadly, the overriding purposes of the trust. For example, distilling the results of scores of cases, the Restatement (Third) of Trusts concludes that there is a presumption that the "trustee's discretion should be exercised in a manner that will avoid either disqualifying the beneficiary for other benefits or expending trust funds for purposes for which public funds would otherwise be available."[281]

Third-party created trusts under which the trustee is given the discretion to provide for the beneficiary's support may or may not disqualify the beneficiary from receiving public assistance. If the settlor directs that the beneficiary's support be provided from the trust, without granting the trustee discretion in that regard, the trust assets clearly will be available resources of the beneficiary for public benefits eligibility purposes.[282] By contrast, a third-party created trust over which the trustee has broad discretion over distributions, without a support standard, should not be an

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[279] *See* UNIF. TRUST CODE § 814(a) (amended 2005), 7C U.L.A. 307 (Supp. 2005). *See also supra* Section VII.

[280] *See* UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 307 (Supp. 2005). Further, the UTC's elimination of the common law distinction between "support trusts" and "discretionary trusts" for creditors rights purposes

> does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard.

Id. § 504 cmt., at 256.

[281] *Id.* § 814 cmt., at 307-08 (quoting RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e & Reporter's Notes (Tentative Draft No. 2, 1999)).

[282] *See, e.g.*, Nason v. Commonwealth, 520 A.2d 1223 (Pa. Commw. Ct. 1987), *vacated*, 533 A.2d 435 (Pa. 1987). *See also* KRUSE, *supra* note 162, at 51-52.

available resource that will disqualify the beneficiary from public benefits.[283] Considerably more difficult are cases in which the trustee is given discretion over distributions for the beneficiary's support. In many discretionary support trust cases, the trust assets have been held not available to the beneficiary for public benefits qualification purposes (or insulated from a state creditor seeking reimbursement for the costs of support it provided), while in many others the trust assets were treated as disqualifying available resources (or as subject to the state's reimbursement claim).[284]

An important—indeed often determinative—factor in resolving such cases is the court's analysis of whether the settlor intended the trust to provide for the beneficiary's support, or whether the settlor intended that, if the beneficiary otherwise qualified for public support, the trust assets would not be available for that purpose.[285] While the UTC affirms the importance of the settlor's intent in a variety of contexts,[286] it does not address how to interpret the terms of a trust to ascertain the settlor's intent. As discussed above, however, in acknowledging that the rights and duties of the beneficiaries and trustee for discretionary distributions depend on a variety of factors, including the purposes of the trust, the comment to section 814 quotes the Third Restatement presumption that the trustee's discretion is to be exercised in a way that preserves the beneficiary's eligibility for public benefits and does not expend trust funds for purposes for which public funds otherwise would be available.[287] As a result, and because (1) the UTC treats trusts for the support of beneficiaries as discretionary trusts,[288] (2) the UTC does not treat discretionary trusts without support standards as support trusts,[289] and (3) the UTC does not enhance the ability of beneficiaries of discretionary trusts to compel distributions,[290] the UTC should not have an adverse effect on the uncertain

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[283] *See, e.g., Simpson*, 906 P.2d at 177-79.

[284] A 2002 analysis of the results of 54 discretionary support trust cases reports that the trust assets were insulated from the state in 30 cases, and not insulated in 24. *See* KRUSE, *supra* note 162, at 117-28.

[285] *See* KRUSE, *supra* note 162, at 55-58.

[286] *See, e.g.*, UNIF. TRUST CODE prefatory note (amended 2005), 7C U.L.A. 178 (Supp. 2005). Under Section 105(a), the terms of the trust generally override conflicting provisions of the Code. *See id.* § 105(a), at 200.

[287] *See supra* note 281 and accompanying text.

[288] *See supra* notes 153-55 and accompanying text.

[289] *See supra* notes 156-59 and accompanying text.

[290] *See supra* Section VII.

treatment of discretionary support trusts for public benefits eligibility purposes.[291]

Public benefits cases involving trusts in which the trustee s given broad discretion over distributions, without a support standard or language limiting distributions to the beneficiary's supplemental needs, are rare.[292] In the all too common discretionary support trust cases, however, courts have found that assets in discretionary trusts are considered as available resources of the beneficiary only to the extent of distributions actually made.[293] Further, as previously noted, many cases in which the trustee was granted discretion over distributions have held that trusts are not available resources of the beneficiaries even when a support standard also is included.[294] Thus, a purely discretionary trust, without a support standard (or language limiting distributions to providing for supplemental needs), will

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[291] The planning lesson is clear:

> [W]hen lawyers consider Medicaid eligibility, unless the settlor intends the trust to be used for the beneficiary's support, language that specifically authorizes the trustee to use the entrusted funds for support purposes is inappropriately written. Beneficiaries of such trusts who are eligible for public medical benefits may or may not be able to continue receiving public support for basic necessities through dispensing agencies while at the same time receiving discretionary payments from privately endowed trusts for other purposes. The discretionary trust corpus may be deemed available for basic living needs. The case law is not consistent. The discretionary support trust is, therefore, an unreliable method by which settlors can continue to provide for their beneficiaries' additional needs beyond basic necessities. The funds are at risk held in such trusts. The language encourages eager state agencies and their employees to attempt its indirect seizure. "Use it. Reapply (for public funds) when it's gone" may be their message.

KRUSE, *supra* note 162, at 69 (footnotes omitted). The problems discretionary support trusts create for their beneficiaries who attempt to qualify or remain qualified for public assistance are serious, but they are neither created nor exacerbated by the UTC.

[292] Mr. Kruse's 2002 comprehensive compilation and analysis of public benefits cases that involved third-party created trusts characterizes only one—*Simpson*, 906 P.2d 174—as involving a trust the terms of which grant the trustee discretion over distributions, but do not include a support standard and do not limit distributions to the beneficiary's supplemental needs. *See* KRUSE, *supra* note 162, at 117-28. Perhaps the scarcity of such cases is because the assets of the trusts clearly are not considered available for public benefits qualification purposes and generally are not challenged by state agencies. For a case in which the trustee was granted the "absolute and uncontrolled" discretion over distributions, but with precatory language indicating the settlor's "fond hope" that the trustee would provide for the beneficiaries' support, see Zeoli v. Comm'r of Soc. Servs., 425 A.2d 553 (Conn. 1979) (holding that the trust assets were not disqualifying available resources).

[293] *See, e.g., Linser*, 672 N.W.2d at 646-47.

[294] *See supra* note 284.

clearly not be counted as an available resource of its beneficiary for public benefits eligibility purposes. For the reasons set forth in the discussion of discretionary support trusts, above,[295] the UTC will have no effect on that result.

D. Under the UTC, Would a Public Benefits Provider Be Able to Recover the Costs of the Support It Provided To a Beneficiary of a Spendthrift Trust from the Trust's Assets?

No. As previously discussed, the UTC does not include a necessities provider exception to spendthrift protection.[296]

E. Under the UTC, Would a Public Benefits Provider Be Able to Recover the Costs of the Support It Provided To a Beneficiary of a Discretionary Trust by Compelling Discretionary Distributions It Could Reach?

No. Also as previously discussed, there is no exception for claims of the state or other necessities providers from the UTC's general prohibition against creditors of a beneficiary compelling discretionary distributions they can reach.[297]

F. If a State Enacts a Statute Making It a Spendthrift Exception Creditor,[298] Would a Beneficiary of an SNT Who Also Is Receiving Medicaid Benefits Be Able to Continue Receiving Benefits from the SNT?

Yes. Generally, the state's claim for Medicaid reimbursement, which does not arise until after the death of the survivor of the Medicaid recipient and his or her spouse, is to recover its costs from the recipient's estate.[299] Accordingly, the state would not be a creditor of the Medicaid recipient during his or her life, and would thus not be able to attach distributions from the SNT, or otherwise reach it, regardless of whether the trust terms include a spendthrift provision or the state is a spendthrift

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[295] *See supra* notes 282-91 and accompanying text.

[296] *See supra* notes 42-46 and accompanying text.

[297] *See supra* note 109 and accompanying text.

[298] *See, e.g.*, KY. REV. STAT. ANN. § 381.180(6)(c) (LexisNexis 2002).

[299] *See* 42 U.S.C. § 1396p(b)(1) (1993). *See also* Davis & Kent, UTC & SNTs, *supra* note 257, at 58-59. For a case in which the "estate" subject to repayment of the state's claim was held to include the assets of a testamentary trust established for the recipient with the amount that he otherwise would have been entitled to receive as an elective share, see Estate of DeMartino v. Div. of Med. Assistance and Health, 861 A.2d 138 (N.J. Super. App. Div. 2004).

exception creditor.

X. DIVORCE AND THE UTC

The UTC addresses divorce only in the context of the rights of a former spouse or child (with a judgment or court order for support or maintenance) of a beneficiary of a spendthrift or discretionary trust to alimony or child support.[300] Its critics claim that it will have a variety of other adverse consequences to a beneficiary of a third-party created trust who divorces.[301]

A. Under the UTC, If a Beneficiary of a Third-party Created Trust Divorces, May His or Her Ex-spouse Reach the Beneficiary's Interest in the Trust to Satisfy an Alimony Claim?

Yes, if certain conditions are met. As previously discussed, if the ex-spouse has a judgment or court order for support or maintenance, under the UTC a spendthrift provision will not protect the beneficiary's interest.[302] The ex-spouse's remedy is to attach present or future distributions to or for the benefit of the beneficiary, provided that the court may limit any award "to such relief as is appropriate under the circumstances."[303] If the trust provides for distributions to be at the trustee's discretion, the ex-spouse may compel distributions he or she can reach, but only if (1) he or she has a judgment or court order for support or maintenance and (2) in not making the distribution, the trustee has not complied with a standard of distribution or has abused a discretion.[304] In that case, the UTC provides for the court to order the trustee to pay to the ex-spouse "such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion."[305] Also as previously discussed, there is much support for the UTC's treatment of an ex-spouse as a spendthrift exception creditor, but limited support for its allowing an ex-spouse to compel

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[300] *See* UNIF. TRUST CODE § 503(b)(1) (amended 2005), 7C U.L.A. 253 (Supp. 2005); *id.* § 504(c)(1), at 256.

[301] *See, e.g.*, Mark Merric, Carl Stevens, & Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream*, 41 EST. PLAN. 33 (2004).

[302] *See* UNIF. TRUST CODE § 503(b)(1) (amended 2005), 7C U.L.A. 253 (Supp. 2005). *See also supra* notes 27-29 and accompanying text.

[303] UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).

[304] *See id.* § 504(c)(1), at 256.

[305] *Id.* § 504(c)(2).

discretionary distributions.[306]

B. Will the UTC Affect Whether a Beneficiary's Trust Interest Will Be Divisible in a Divorce?

The UTC does not address the division of property in a divorce. In most states, generally only "marital property"[307] is subject to division.[308] Because a divorcing spouse's interest in a third-party created trust generally will have been received by gift or inheritance, in most states it will be separate property that is not subject to division, regardless of the extent or nature of the beneficiary's interest in the trust.[309] In states in which separate property is divisible,[310] however, or in which the income from, or appreciation in, separate property is marital property (and thus divisible),[311] part or all of a beneficiary's interest in a trust may be divisible in a divorce,[312] regardless of whether the UTC has been enacted.

If under applicable state law part or all of a beneficiary's interest in a third-party created trust is not protected from division in divorce by virtue of its being separate property, its divisibility in a given case may depend on one or more of a multitude of factors, such as (1) whether the beneficiary's interest is in a trust created by another that is revocable by its still

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[306] *See supra* notes 28-29, 117-18 and accompanying text.

[307] The definition of "marital property" will vary by jurisdiction. By way of example, the Uniform Marriage and Divorce Act, as originally promulgated, defined "marital property" as "all property acquired by either spouse subsequent to the marriage" other than property (1) acquired by gift or inheritance, (2) acquired in an exchange for separate property, (3) acquired after a decree of legal separation, (4) excluded by agreement, or (5) representing the increase in the value of property acquired before the marriage. UNIF. MARRIAGE AND DIVORCE ACT § 307 (amended 1973), 9A U.L.A. 289 (1998).

[308] *See* BRETT R. TURNER, EQUITABLE DISTRIBUTION OF PROPERTY § 2.08 (2d ed. 1994).

[309] *See id.* § 6.28.

[310] In some states, all of a couple's assets, without regard to when or how acquired, are subject to division at divorce. *See id.* § 2.07. Further, in some of the states in which separate property generally is not divisible, it may be awarded to the other spouse if, for example, failure to make an award will result in undue hardship. *See id.* § 8.12.

[311] *See id.* §§ 5.21-5.22.

[312] *See, e.g.*, Davidson v. Davidson, 474 N.E.2d 1137 (Mass. App. Ct. 1985).

living settlor;[313] (2) whether the beneficiary's interest is vested;[314] (3) whether the beneficiary's interest may be defeated by another's exercise of a power of appointment;[315] (4) whether the beneficiary's interest may be eliminated by discretionary distributions to another beneficiary, or by another beneficiary's power to invade principal;[316] (5) whether the beneficiary's interest is a remainder;[317] (6) whether the beneficiary's interest is an income interest;[318] or (7) whether the beneficiary's interest is subject to

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[313] *See, e.g., In re* Marriage of Gorman, 36 P.3d 211 (Colo. Ct. App. 2001) (holding that the beneficiary's vested interest in the trust, though subject to divestment by the settlor's revocation or amendment, was property subject to division), *superseded by statute*, COLO. REV. STAT. § 14-10-113(7)(b) (2004). The new legislation effectively overruled *Gorman* shortly after it was decided.

[314] For a case holding that only vested interests in trust are divisible, see *In re* Marriage of Beadle, 968 P.2d 698, 705 (Mont. 1998). *See also* McGinley v. McGinley, 565 A.2d 1220 (Pa. Super. Ct. 1989). Whether an interest is vested in the traditional property law sense, however, should not be determinative of its divisibility in divorce. For example, a gift "to my spouse, S, for life, remainder to my child, C, if C survives my spouse; if not to X" creates a contingent remainder in C, while a gift "to my spouse, S, for life, remainder to my child, C, provided that if C does not survive S, remainder to X" creates a vested remainder, subject to divestment, in C. *See* DUKEMINIER ET AL., *supra* note 221, at 627-28. Because C's interest in the two examples is not substantively different, they should not be treated differently in a divorce. *See also* Stern v. Stern, 331 A.2d 257, 262 (N.J. 1975) ("[T]he concept of vesting should probably find no significant place in the developing law of equitable distribution."); S.L. v. R.L., 774 N.E.2d 1179, 1182 (Mass. App. Ct. 2002) (treating beneficiary's remainder interest as divisible property despite being contingent on the beneficiary surviving her mother); TURNER, *supra* note 308, § 6.28; Marc A. Chorney, *Interests in Trusts as Property in Dissolution of Marriage: Identification and Valuation* 40 REAL PROP. PROB. & TR. J. 1, 6-11 (2005).

[315] *See, e.g., S.L.*, 774 N.E.2d at 1182 (holding that beneficiary's parent's power to appoint the trust estate to others precluded treating beneficiary's interest as property subject to division). *See also* Chorney, *supra* note 314, at 8-11.

[316] *See, e.g., In re* Marriage of Balanson, 25 P.3d 28, 40-41 (Colo. 2001) (holding that beneficiary's remainder interest was property subject to division despite her father, the income beneficiary and trustee, having the power to distribute principal to himself for his support, care, and maintenance); *Davidson*, 474 N.E.2d at 1143-44 (holding that beneficiary's remainder interest in a trust created by his father was divisible despite the trustee's having the "uncontrolled discretion" to invade principal for his mother).

[317] "The general rule is . . . that the remainder interest in a trust constitutes *property* which can be divided upon divorce." TURNER, *supra* note 308, § 6.28, at 448. However, "[a] small number of decisions holds that remainder interests are not *property*." *Id.* at n.663.

[318] *Compare In re* Marriage of Guinn, 93 P.3d 568, 569 (Colo. Ct. App. 2004) (not treating mandatory income interest as property subject to division), *with* Fox v. Fox, 626 N.W.2d 660 (N.D. 2001) (treating mandatory income interest as property subject to division). *See also Marriage of Jones*, 812 P.2d 1152 (holding that because beneficiary's interest in a discretionary trust was not property—marital or separate—income distributed

the discretion of the trustee and thus is treated as an expectancy, rather than as divisible property.[319]

While the enactment of the UTC would not affect the application of most of the factors listed in the preceding paragraph, critics argue that a beneficiary's discretionary interest in a trust would more likely be divisible under the UTC than under non-UTC law.[320] Commentators have observed that a Colorado case, *Marriage of Jones*,[321] illustrates the protection the common law affords discretionary trust interests in divorce that would be lost by enactment of the UTC.[322] *Jones* was a divorce proceeding involving a testamentary trust the wife's mother had created.[323] The trustees—the testator's husband (the wife's father) and a bank—were granted the "uncontrolled discretion" to make distributions of income and principal as they determined necessary for the health, welfare, comfort, support, maintenance and education of the testator's husband, the wife, and the wife's descendants.[324] Unless earlier terminated by discretionary distributions, the trust was to terminate, at the earliest, at the wife's death.[325] The remainder beneficiaries were the wife's descendants, if any, or the testator's heirs.[326] The court held that because the wife's receipt of distributions was subject to the "uncontrolled" discretion of the trustees, her interest in the trust was not property subject to division.[327]

UTC critics argue that the UTC would change the result in cases like

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to beneficiary at the trustee's discretion was a non-divisible gift); Friebel v. Friebel, 510 N.W.2d 767 (Wis. Ct. App. 1993).

[319] *See, e.g., Marriage of Jones*, 812 P.2d 1152; *In re* Rosenblum, 602 P.2d 892 (Colo. Ct. App. 1979); Hawkins v. Hawkins, 526 A.2d 872 (Conn. Ct. App. 1987); *In re* Eddy, 569 N.E.2d 174 (Ill. App. Ct. 1991).

[320] *See* Merric, Stevens, & Freeman, *supra* note 301, at 47.

[321] 812 P.2d 1152.

[322] *See* Merric, Stevens, & Freeman, *supra* note 301, at 47.

[323] *Marriage of Jones*, 812 P.2d at 1153.

[324] *See id.*

[325] *See id.*

[326] *See id.*

[327] *See id.* at 1157. In Massachusetts, a divorcing spouse's interest in a discretionary trust may not be excluded from division:

> [W]hile a judge is not necessarily precluded from including within the marital estate . . . a party's beneficial interest in a discretionary trust, because of the peculiar nature of such a trust, the trust instrument and other relevant evidence must be examined closely to determine whether that party's interest is too remote or speculative to be so included.

D.L. v. G.L., 811 N.E.2d 1013, 1023 (Mass. App. Ct. 2004) (citation omitted).

Jones.[328] The argument focuses on (1) the UTC's elimination of the distinction between discretionary and support trusts, (2) the UTC's standard of review of the trustee's exercise of discretion, and (3) the UTC's acknowledgment of the right of a beneficiary of a discretionary trust to sue to compel distributions if the trustee abuses its discretion or fails to comply with a standard for distribution.[329] The rationale for the court's decision in *Jones* was that the wife had no right to receive current or future distributions; rather, distributions were to be made at the sole discretion of the trustee.[330] The UTC's elimination of the distinction between discretionary and support trusts for purposes of sections 501 and 504, which does not affect the duties and rights of the trustee and the beneficiaries with respect to discretionary distributions,[331] should have no effect on that analysis.[332] Further, subsection 814(a)'s standard of judicial review for the exercise of discretion by a trustee is not substantively different from the four standards[333] referred to in *Jones*,[334] and thus also should not have affected its result. Finally, a beneficiary of a discretionary trust always has had the ability to bring an action to compel distributions for abuse of discretion or failure to comply with a standard of distribution.[335] Thus, the UTC's statement in section 504(d) that the remainder of section 504 does

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[328] *See* Merric, Stevens, & Freeman, *supra* note 301, at 47.

[329] *See id.*

[330] *See Marriage of Jones*, 812 P.2d at 1156-57.

[331] *See* UNIF. TRUST CODE § 504 cmt. (amended 2005) 7C U.L.A. 56 (Supp. 2005). *See also supra* Section VI.

[332] Note, however, that the discretionary trust in *Jones* included a support standard, and that in many jurisdictions, in litigation involving public benefits, discretionary support trusts have been held to create enforceable standards for distributions for support. *See supra* note 284 and accompanying text.

[333] *See supra* note 210.

[334] *See supra* Section VII. Subsection 814(a) requires trustees to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. UNIF. TRUST CODE § 814(a) (amended 2005), 7C U.L.A. 307 (Supp. 2005). As discussed *supra* at notes 201-17 and accompanying text, language like that used in *Jones* to describe the minimum standard of conduct required of a trustee with discretionary powers is another way of requiring that a trustee act in good faith. Furthermore, three of the four different formulations of the minimum standard of conduct described in *Jones* include requirements that the trustee not abuse its discretion or act from an improper motive. *See supra* note 210. A trustee who does not exercise its discretion in accordance with the purposes of the trust or the interests of the beneficiaries (as described in the terms of the trust, *see* UNIF. TRUST CODE § 103(8) (amended 2005), 7C U.L.A. 192 (Supp. 2005)), presumably would have abused its discretion or acted from an improper motive.

[335] *See supra* notes 182-84 and accompanying text.

not limit the beneficiary's rights in that area also would have had no effect on the result in *Jones*.

C. Will the UTC Affect Whether a Beneficiary's Interest in a Discretionary Trust, Even if Not Divisible, Will Be Considered in Dividing the Couple's Property?

It should not. In making an equitable division of a divorcing couple's property, some states consider the spouses' economic circumstances.[336] For example, in *Jones*, discussed above, the court held that the wife's discretionary interest in her mother's trust was not property subject to division, but was an economic circumstance to be considered in equitably dividing the couple's marital property.[337] Again based on the claim that the UTC creates expanded rights to distributions in beneficiaries of discretionary trusts, the argument has been made that a beneficiary's interest in a discretionary trust under the UTC will be more valuable than it otherwise would, thus adversely affecting the beneficiary in the division of property when the couple's economic circumstances are taken into consideration.[338] Because the UTC does not affect the duties and rights of the trustee and beneficiaries with respect to discretionary distributions,[339] that should not be the case.

D. Will the UTC Affect Whether a Beneficiary's Interest in a Discretionary Trust Will Be Considered For Purposes of Awarding Spousal Maintenance or Child Support Against the Beneficiary?

Among the factors that may affect an award of spousal maintenance or child support in a divorce are the financial resources of the spouses.[340] UTC critics also argue that a beneficiary of a discretionary trust in a UTC jurisdiction will, by virtue of the trust interest, have income imputed to the beneficiary for purposes of awarding spousal maintenance or child support against him or her.[341] Again, the argument is based on the claim that

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[336] *See, e.g.*, COLO. REV. STAT. § 14-10-113(1)(c) (West 2004); MO. ANN. STAT. § 452.330.1(1) (West 2003). *See also* Athorne v. Athorne, 128 A.2d 910 (N.H. 1957). The future financial needs of the spouses also is a factor that commonly is considered in equitably dividing a couple's property. *See* TURNER, *supra* note 308, § 8.08.

[337] *See Marriage of Jones*, 812 P.2d at 1158.

[338] *See* Merric, Stevens, & Freeman, *supra* note 301, at 49.

[339] *See supra* Section VII.

[340] *See, e.g.*, UNIF. MARRIAGE AND DIVORCE ACT § 308 (amended 1973), 9A U.L.A. 446-47 (1998); *id.* § 309, at 573.

[341] *See* Merric, Stevens, & Freeman, *supra* note 301, at 49-50. While not based on an

beneficiaries of discretionary trusts under the UTC have expanded rights to compel distributions, and again, the response is that they do not.[342]

XI. BANKRUPTCY AND THE UTC

Another concern UTC critics have expressed is that it will have an adverse effect on trust beneficiaries who go through bankruptcy.[343] Because (1) most trust instruments include spendthrift provisions,[344] (2) bankruptcy law respects spendthrift trusts that are effective under state law,[345] and (3) spendthrift trusts (with limited exceptions) are effective under the UTC,[346] the UTC should have little or no effect on beneficiaries of third-party created trusts in the bankruptcy context.

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imputation of income theory, a pre-UTC case held that although the discretionary nature of a beneficiary's interest in the principal of a trust protected it from being reached by his spouse, the discretionary interest could be considered in determining both alimony and the division of property. *See Athorne*, 128 A.2d 910.

[342] *See supra* Section VII. The argument is also based on a recent Massachusetts case, Dwight v. Dwight, 756 N.E.2d 17 (Mass. App. Ct. 2001). *See* Merric, Stevens, & Freeman, *supra* note 301, at 50. *Dwight*, however, does not support that argument. In *Dwight*, which was not decided under the UTC, the spouses entered into a separation agreement under which the wife was expressly authorized to bring an action for alimony if, among other things, the husband received "a substantial inheritance which increases his income." *Dwight*, 756 N.E.2d at 18-19. Thereafter, the husband's father died and left approximately $435,000 to a discretionary support trust for the husband and his issue. *Id.* at 19-20. The appellate court first affirmed the trial court's determination that the gift, though left to the discretionary support trust for the husband and his issue, constituted a substantial inheritance within the meaning of the separation agreement. *Id.* at 20-21. Next, the court also affirmed the lower court's finding that the substantial inheritance increased the husband's income, even though only one $7,000 distribution had been made to the husband from the trust over a several-year period. *Id.* at 21. The appellate court determined that finding, which was based on the fact that the husband had told the trustee that he did not want any income from the trust and on the broad purposes for which discretionary payments could be made to the husband, was not clearly erroneous. *Id.* The court also noted that under Massachusetts law, if the trustee had determined that the husband needed distributions from the trust, the trustee would have been under a duty to provide them. *Id.* n.5.

[343] See, e.g, Merric & Oshins, *supra* note 1, at 484-85.

[344] *See supra* note 100 and accompanying text.

[345] *See* 11 U.S.C. § 541(c)(2) (2000).

[346] *See* UNIF. TRUST CODE § 502 (amended 2005), 7C U.L.A. 251-52 (Supp. 2005); *id.* § 503, at 253.

A. Under the UTC, May Creditors of a Beneficiary of a Spendthrift Trust Reach the Beneficiary's Interest In the Trust Through a Bankruptcy Proceeding?

Generally, no. Under the Bankruptcy Code, a trust interest that is not alienable under applicable state law does not become a part of the bankruptcy estate.[347] Under the UTC, a beneficiary's interest in a spendthrift trust is not alienable (except with respect to exception creditors).[348]

B. If the Terms of the Trust Do Not Include a Spendthrift Provision, Would a Bankrupt Beneficiary's Interest In a Third-party Created Trust Governed By the UTC Become Part of the Bankruptcy Estate?

Generally, a debtor's bankruptcy estate includes all interests in property, including equitable interests in trusts, owned by the debtor at the time of bankruptcy filing.[349] The exception that protects spendthrift trusts, however, is not limited to trusts that include spendthrift provisions. Rather, the exception provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."[350] If a beneficiary's interest in a third-party created trust is subject to the trustee's discretion, including to make distributions for the beneficiary's support, the interest may be protected from becoming a part of the beneficiary's bankruptcy estate even if the terms of the trust do not include a spendthrift provision.[351] Because decisions so holding are based on the beneficiaries of the trusts being unable to compel distributions,[352] and because the UTC does not change the duties and rights of the trustee and beneficiaries with

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[347] *See* 11 U.S.C. § 541(c)(2) (2000). For two recent cases under which this provision protected debtors' interests in spendthrift trusts, see *In re* Wachter, 314 B.R. 365 (Bankr. E.D. Tenn. 2004) and *In re* Spencer, 306 B.R. 328 (Bankr. C.D. Cal. 2004).

[348] *See* UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005).

[349] *See* 11 U.S.C. § 541(a)(1) (2000).

[350] *Id.* § 541(c)(2).

[351] *See, e.g., In re* Britton, 300 B.R. 155 (Bankr. D. Conn. 2003); *In re* Knight, 164 B.R. 372 (Bankr. S.D. Fla. 1994); *In re* Pechenec, 59 B.R. 899 Bankr. (D. Kan. 1986). In dictum, however, in a case that involved the denial of discharge to a debtor who did not meet the Bankruptcy Code's disclosure requirements, a bankruptcy court stated that the protection afforded by section 541(c)(2) is limited to spendthrift trusts and is not available to discretionary trusts without spendthrift provisions. *See In re* Katz, 203 B.R. 227 (Bankr. E.D. Pa. 1996).

[352] *See Knight*, 164 B.R. at 376 n.2; *Pechenec*, 59 B.R. at 904-05; *Britton*, 300 B.R. at 158-59.

respect to discretionary distributions from third-party created trusts,[353] the same protection in bankruptcy for discretionary interests in non-spendthrift trusts should be available under the UTC as is available under non-UTC law. Clearly, though, the simplest and safest course for obtaining protection in bankruptcy for a beneficiary's interest in a third-party created trust is to include a spendthrift provision in the instrument.

XII. CONCLUSION

Article 5 of the UTC, dealing with the rights of creditors of trust beneficiaries and settlors, and subsection 814(a), describing the standard to which trustees will be held in the exercise of discretion, regardless of its breadth, have raised a number of concerns among some trusts and estates lawyers. A number of amendments to the UTC and its comments have been made since its promulgation in 2000 that address many of those concerns:

1. The definition of "power of withdrawal" in section 103(11) was amended to avoid a beneficiary/trustee, whose power to distribute for the beneficiary/trustee's own benefit is limited by an ascertainable standard, from being treated as a settlor of a revocable trust for creditors' rights purposes under section 505(b)(1).[354]
2. Section 501 and its comment were amended to make it clear that its broad remedies are available to a creditor only if the terms of the trust do not include a spendthrift provision, or the provision does not apply to a particular beneficiary's interest.[355]
3. The comment to section 501 also was amended to (1) acknowledge that a beneficiary's interest may be too indefinite or contingent for a creditor to reach, or may qualify for an exemption under the jurisdiction's general creditor exemption statutes, (2) delete a paragraph describing creditor remedies and procedures, and (3) delete the reference to the beneficiary's support needs in its discussion of the court's ability to limit a creditor's award as appropriate under the circumstances.[356]
4. Section 503 was amended to specify that the remedy under the UTC for a spendthrift exception creditor is limited to the attach-

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[353] *See supra* Section VII.

[354] *See* UNIF. TRUST CODE § 103(11) (amended 2005), 7C U.L.A. 192 (Supp. 2005).

[355] *See id.* § 501 & cmt., at 250-51.

[356] *Compare id.* § 501 cmt. *with* UNIF. TRUST CODE § 501 cmt. (2004), 7C U.L.A. 250-51 (Supp. 2005) (amended 2005).

ment of present or future distributions to or for the benefit of the beneficiary,[357] and to authorize the court to limit a creditor's award as appropriate under the circumstances.[358]

5. Section 504 was amended to clarify that most creditors of a beneficiary may not compel discretionary distributions even if the beneficiary/debtor is the trustee, if distributions for the beneficiary/trustee are limited by an ascertainable standard and the creditor otherwise may not reach the interest.[359]
6. The comment to section 504 was amended to clarify that section 504's elimination of the distinction between discretionary and support trusts for creditors' rights purposes does not affect the duties and rights of the trustee and beneficiary with respect to distributions.[360]
7. Section 506 was amended to add a narrow definition of a "mandatory distribution" from a trust that a creditor may reach if it is not made within a reasonable time after its designated distribution date.[361]
8. The comment to section 814 was amended to acknowledge that other than requiring trustees to exercise discretionary powers in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, the UTC does not address the duties and rights of the trustee and beneficiaries with respect to discretionary distributions. Rather, the comment states that those duties and rights will continue to be governed by case law and factors such as the precise language used in the instrument, whether and if so the extent to which discretion is granted, whether a standard for distributions is provided, whether the beneficiary has other resources, and the overriding purposes of the trust.[362]

These amendments have improved the UTC and addressed many concerns that have been raised about its creditors' rights provisions. Generally, for third-party created spendthrift and discretionary trusts, the UTC provides as much or more protection to beneficiaries' interests than does

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[357] *See* UNIF. TRUST CODE § 503(c) (amended 2005), 7C U.L.A. 253 (Supp. 2005).
[358] *See id.*
[359] *See id.* § 504(e), at 256.
[360] *See id.* § 504 cmt., at 256-57.
[361] *See id.* § 506(a), at 261.
[362] *See id.* § 814 cmt., at 307-09.

the common law. By not recognizing an exception for the claims of necessities providers,[363] narrowing the exception for government claimants,[364] and codifying an exclusive list of exception creditors that bars tort claimant and other public policy exceptions,[365] the UTC has strengthened spendthrift protection. Further, as a general rule, no creditor of a beneficiary, even one who has provided support to the beneficiary, may compel discretionary distributions it can reach.[366] The only exception to that rule is for child and spousal support claimants, and their ability to compel discretionary distributions is dependent on (1) their having a judgment or court order for support or maintenance and (2) the trustee's failure to make distributions being an abuse of discretion or a failure to comply with a standard for distributions.[367]

The UTC will not increase the ability of beneficiaries of third-party created trusts to compel discretionary distributions.[368] Requiring a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, as the UTC does in subsection 814(a), is a codification of the common law.[369] The new comment to section 504 explicitly notes that the UTC's elimination of the distinction between discretionary and support trusts for purposes of sections 501 and 504 has no effect on the rights and duties of the beneficiaries and the trustee with respect to distributions.[370] Similarly, the new comment to section 814 explicitly provides that other than requiring the trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, subsection 814(a) does not address distribution issues, leaving them to case law, and affirms that those issues will continue to be dependent on factors such as whether the trustee is granted discretion, the extent of discretion granted, and whether the instrument includes a support or other standard.[371]

Qualification for public benefits of a beneficiary of a special or sup-

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[363] *See id.* § 503(b), at 253.

[364] *See supra* notes 37-38 and accompanying text.

[365] *See* UNIF. TRUST CODE § 502(c) (amended 2005), 7C U.L.A. 252 (Supp. 2005); *id.* § 503(b), at 253.

[366] *See id.* § 504(b), at 256.

[367] *See id.* § 504(c)(1).

[368] *See supra* Section VII.

[369] *See supra* notes 201-42 and accompanying text.

[370] *See* UNIF. TRUST CODE § 504 cmt. (amended 2005), 7C U.L.A. 256-57 (Supp. 2005).

[371] *See id.* § 814 cmt., at 307-09.

plemental needs trust will not be adversely affected by the UTC.[372] While beneficiaries of discretionary support trusts have been denied public benefits in many cases in non-UTC jurisdictions,[373] the new comment to section 814 may help avoid that result by its reference to the Third Restatement's presumption that the trustee's discretion should not be exercised in a way that disqualifies the beneficiary from benefits or for purposes for which public funds otherwise are available.[374] Further, from a planning perspective, the SNT discretionary support trust problem is easily avoided by drafting trusts either as supplemental needs trusts or as discretionary trusts without support standards.

In the area of divorce, most or all of a beneficiary's interest in a third-party created trust will be protected separate property in most states.[375] Because a beneficiary has no greater rights to receive distributions under the UTC than under non-UTC law,[376] if the interest is discretionary it may also be protected from division on that ground under the UTC to the same extent as under non-UTC law.[377] A discretionary interest may be an economic circumstance that will affect the division of a couple's divisible assets and whether, and if so in what amount, a spousal maintenance or child support award will be issued.[378] That is the case under existing non-UTC law, and enactment of the UTC should not affect such divisions or awards one way or the other.

Finally, a beneficiary's interest in a discretionary, non-spendthrift trust may be protected in bankruptcy under the UTC to the same extent as under non-UTC law.[379] The issue will rarely arise, however, as spendthrift provisions, which are routinely used in third-party created trusts, are effective to exclude from the beneficiary's bankruptcy estate a beneficiary's interest in a third-party created trust.[380]

In short, the UTC does not adversely affect the protections from creditors' claims that third-party created spendthrift and discretionary trusts have traditionally provided to their beneficiaries.

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[372] *See supra* Section IX.

[373] *See supra* note 284 and accompanying text.

[374] *See* UNIF. TRUST CODE § 814 cmt. (amended 2005), 7C U.L.A. 307-09 (Supp. 2005).

[375] *See supra* notes 307-12 and accompanying text.

[376] *See supra* Section VII.

[377] *See supra* notes 320-35 and accompanying text.

[378] *See supra* notes 336-42 and accompanying text.

[379] *See supra* notes 349-53 and accompanying text.

[380] *See* 11 U.S.C. § 541(c)(2) (2000).

Davis/Kent Article

THE IMPACT OF THE UNIFORM TRUST CODE ON SPECIAL NEEDS TRUSTS

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Both authors are members of NAELA, are Fellows of the American College of Trust & Estate Counsel, have worked with the National Uniform Trust Code Committee on issues regarding creditor rights and SNTs, spoke at NCCUSL's first annual National UTC Conference in 2005 on the topic of this paper and will speak on this topic at the 2006 ACTEC annual meeting, and their materials on this topic have been published in *Estate Planning*, *Trusts & Estates*, *Probate Law Journal of Ohio*, and elsewhere.

I. INTRODUCTION

During the last year, some practitioners have raised concerns that the Uniform Trust Code ("UTC") will negatively affect Special Needs Trusts ("SNTs").[1] This paper provides an in-depth analysis of the issues that are involved in this debate. This paper also demonstrates conclusively that the UTC poses no threat either to self-settled or to third party-settled SNTs.[2] Article 5 of the UTC "Creditor's Claims; Spendthrift and Discretionary Trusts," as well as Section 814, "Discretionary Powers; Tax Savings" raises the primary areas of concern as they relate to SNTs. The issues fall into three main areas of concern:

1) Will the UTC allow governmental entities that provide benefits to an SNT beneficiary to reach the trust assets or attach trust distributions?
2) Will SNTs be countable resources, thereby causing the beneficiary to lose eligibility for public benefits to which the beneficiary would have otherwise been entitled, because of UTC?
3) Will the UTC provide the general creditors of an SNT beneficiary increased ability to reach trust assets or to attach trust distributions?

The answer to all three questions is "NO!"

1. *See* the three-part article by Mark Merric and Steven J. Oshins, "The Effect of the UTC on the Asset Protection of Spendthrift Trusts," *Estate Planning* (Aug., Sep., and Oct., 2004) and the response to that series of articles by Suzanne Brown Walsh, Richard E. Davis, Stanley C. Kent, and Alan Newman, "What is the Status of Creditors under the Uniform Trust Code?", *Estate Planning* (Feb. 2005); *see also* Mark Merric and Douglas W. Stein, "A Threat to All SNTs," *Trusts & Estates* (Nov. 2004) and the responses by Richard E. Davis, "UTC is No Threat to SNTs," *Trusts & Estates* (Jan. 2005) and Stanley C. Kent and Richard E. Davis, "The Uniform Trust Code and Supplemental Needs Trusts," *Probate Law Journal of Ohio* (Jan./Feb. 2005); *see also* Mark Merric, Douglas Stein, Carl Stevens, Eric Solem, Wayne Stewart and Mark Osborne, "The Uniform Trust Code: A Continued Threat to SNTs Even After Amendment," *Journal of Practical Estate Planning* (Apr./May 2005), which article is purportedly the first installment of a three part series.
2. For purposes of this outline, "special needs trusts" and "supplemental needs trusts" are generically combined under the term "special needs trusts" (SNTs).

II. GOVERNMENTAL PROVIDERS OF PUBLIC BENEFITS AS CREDITORS

A. Governmental entities that pay out public benefits to disabled individuals generally are not creditors.

Individuals who meet the federal definition of being "disabled"[3] may be entitled to receive either Social Security Disability Income ("SSD")[4] or Supplemental Security Income ("SSI").[5] SSD and SSI both consist solely of federal funds, so there is no possibility of the State becoming a creditor with respect to these benefits. There is no federal payback requirement for either SSD or SSI, except for benefits improperly paid. Disabled individuals who qualify for SSD generally also receive Medicare coverage for their health care needs. As is the case with SSD, Medicare generally has no payback requirements.[6]

Disabled individuals who qualify for SSI are usually eligible for Medicaid benefits as well.[7] The States, but not the federal government, are creditors with respect to certain Medicaid benefits paid to certain Medicaid recipients, as set forth below, but generally not until after the death of the recipient.

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3. 42 U.S.C. §1382c(a)(3) (2005).
4. The law governing SSD is found in Title II of the Social Security Act, 42 U.S.C. § 401 (2005) *et seq.* SSD is part of a larger program more fully known as The Old Age Survivors and Disability Insurance (OASDI).
5. There is a great deal of confusion between SSD and SSI. Many disabled individuals who receive these benefits are not aware of which one they are receiving, as both are administered by the Social Security Administration. SSD is not means tested, while SSI has strict income and resource limits. SSI and SSD use the same "disability" definition.
6. TEFRA (Pub. L. 97-248, specifically Title I, § 96 Stat. 370) enacted, and OBRA 1993 (Pub.L. 103-66) modified, what is referred to as the Medicare Secondary Payer (MSP) statute, which is contained in § 1862(b) of the Social Security Act, 42 U.S.C. § 1395y(b) (2005). Regulations are in 42 C.F.R. Part 411. Under MSP, there is a Medicare Coordination of Benefits (COB) program. A Medicare COB Coordinator must be contacted whenever medical services have been rendered to a Medicare recipient that may be related to a Workers Compensation claim or to a personal injury lawsuit, where another payer may have primary liability for the payment of medical expenses. If, however, an SNT were established for a beneficiary covered by Medicare and funded with proceeds from a personal injury settlement, Medicare would have a lien against the SNT if the COB procedures mandated by the MSP statute were not followed. The CMS web page regarding COB is located at http://www.cms.hhs.gov/medicare/cob/factsheets/fs_attorneys_msplaws.asp.
7. In providing Medicaid to individuals who are receiving or deemed to be receiving SSI, states fall into one of three categories. Thirty-two states, referred to as "§ 1634(a) States," have a contract with SSA to determine eligibility for Medicaid as part of the same process used to determine SSI eligibility. These States (and the District of Columbia) also use the same Medicaid eligibility criteria for categorically needy (i.e. blind, disabled, or aged) Medicaid that SSA uses for the SSI program. Seven other states, called "SSI-Criteria States," use the same Medicaid eligibility criteria used by SSA for SSI determinations, but require these individuals apply to the State separately for Medicaid coverage. The remaining eleven states, the "§ 209(b) States," use more restrictive Medicaid eligibility criteria than the criteria used in the SSI program.

B. Federal law mandates Medicaid estate recovery.

The States are required to seek to recover certain Medicaid benefits following the death of the institutionalized recipients and recipients who were over the age of fifty-five.[8] The federal statutes under which States have reimbursement rights with respect to these Medicaid benefits are set forth in Appendix B. The federal government has no right to seek the return of Medicaid benefits; however, the States must share with the federal government a portion of all amounts recovered.

Federal law expressly prohibits States from seeking recovery during the lifetime of the Medicaid recipient, and even after death, federal law contains important safeguards for surviving spouses and certain other individuals. During the lifetime of the Medicaid recipient, the State is not a creditor, except to the extent that the State may have enacted legislation and amended its State plan to permit the use of Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) liens against the residence of certain permanently institutionalized Medicaid recipients.[9]

A State, by passing enabling legislation and by amending its State Plan with the Centers for Medicare & Medicaid Services ("CMS,") may file a lien against the real estate of a "permanently institutionalized" Medicaid recipient during the recipient's lifetime under certain limited circumstances.[10] TEFRA liens attach only to the property interests of the Medicaid recipient. Therefore, if the Medicaid recipient owned an undivided one-half interest in real property, the lien could only attach to the recipient's one-half interest. Real property that a third party settled SNT might own (such as the home in which the beneficiary was residing prior to institutionalization) would not be real property "of" the beneficiary, but, rather, would be property "of" the trust. Moreover, the interest would not be subject to lien under state law, as legal title is vested in the trustee. Unlike the federally mandated OBRA estate recovery, which allows the States flexibility in defining the extent of the "recovery estate," TEFRA provides for no such flexibility.[11]

After the death of a Medicaid recipient, the State must seek to recover certain amounts paid for medical assistance from the "recovery estate." Federal law requires that the "recovery estate" (i.e. the "estate" against which recovery may be sought) consist of "all real and personal property and other assets included within the individual's estate, as defined for purposes of State probate law." States, by enacting enabling legislation, may expand the definition of the recovery estate to include:

> . . .any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including such assets conveyed to a survivor, heir, or assign of the deceased

8. 42 U.S.C. § 1396p(b)(1)(B) (2005).
9. Because each state has certain rights following the death of the Medicaid recipient, before death the state may be a "future creditor" under fraudulent conveyance statutes.
10. *See* Appendix B for a discussion of TEFRA liens.
11. *See* Appendix B.

individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.[12]

Estate recovery rights hinge on two factors, (i) the State's definition of the "recovery estate," (which is not a UTC issue) and (ii) the nature of the Medicaid recipient's interest in the property against which recovery is sought. If, and only to the extent that, the UTC creates in the SNT beneficiary a new or expanded right to compel distributions (which right the beneficiary lacked under prior law), would the UTC enhance the State's recovery rights. The UTC, however, neither creates such a right nor expands any rights that may exist under common law principles.[13]

May a state define the "recovery estate" broadly enough to enable it to recover against assets of an SNT following the death of its beneficiary? The issue is moot with respect to self-settled SNTs, since they are required to include a mandatory Medicaid payback provision. Regarding third party SNTs, the beneficiary has no "legal title" in the assets of the SNT, but probably does have an "other interest" in the trust assets.[14] Recovery, however, can only be made "to the extent of such [i.e. the beneficiary's] interest". Because the beneficiary's interest is generally subject to the trustee's discretion, with no support standard, recovery should not be available. This is very similar to the inability of the federal government to enforce a federal tax lien against the interest of a beneficiary in a discretionary trust that lacks a distribution standard. Generally, where a trust gives the trustee uncontrolled discretion over distributions, the beneficiary does not have an interest that is subject to a federal tax lien; however, distributions made to the beneficiary are subject to attachment.[15] The same analysis should apply in the estate recovery context.[16]

C. Spendthrift Protection against Governmental Entities

Concerns have been expressed that future changes to federal and/or State law may expand the rights of the federal or state governments to seek repayment of governmental benefits, and that the UTC's recognition of the "exception creditor" status of federal and state governments will make it easier for them to recover from SNTs benefits that they have paid.

Just as the federal government is unable to reach assets held in a pure discretionary trust, so would attempts by a state to reach assets held in a discretionary

12. 42 U.S.C. § 1396p(b)(4)(B) (2005).

13. *See* the discussion under II entitled "When can a beneficiary compel a distribution."

14. *In re Marriage of Jones*, 812 P2d. 1152 (Colo. 1991) (recognizing that the beneficiary of a discretionary trust has an equitable interest in the subject matter of the trust, citing 2 Austin W. Scott and William F. Fratcher, The Law of Trusts § 130 (4th ed. 1987).

15. 2A Scott and Fratcher, *supra* n. 12, at §157.4; *United States v. Cohn*, 855 F. Supp. 572 (D. Conn. 1994); *First Northwestern Trust Company v. Internal Revenue Service*, 622 F.2d 387 (8th Cir. 1980); *see also United States v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994) (holding that under state law a beneficiary's interest in a purely discretionary trust is not "property" or "any right to property" within the meaning of the federal tax lien statute before the trustee has exercised its discretionary power to distribute under the trust agreement).

16. *See infra* § II.

SNT following the beneficiary's death be unsuccessful. If so, concerns about the "exception creditor" status of possible governmental claims against SNTs would be unfounded.

Spendthrift protection generally, and UTC spendthrift protection specifically, are not without limits. Spendthrift protection is justified on the notion that a settlor ought to be able to restrict access to a beneficial interest as settlor chooses. Public policy considerations have historically limited spendthrift protection.[17]

Though substantially revised in the 2005 amendments, UTC §503, which was substantially revised in the 2005 amendments, provides "(b) A spendthrift provision is unenforceable against: . . . (3) A claim of this State or the United States to the extent a statute of this State or federal law so provides."[18] The federal government, through preemption, and the States, through their inherent legislative power, have always had the power to provide, and have provided, that spendthrift provisions do not bar certain of their claims.[19] While UTC § 503 previously did not specify the remedy available to a governmental exception creditor, § 503(c) now specifies one remedy for all exception creditors:

> (c) A claimant against which a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances.[20]

Under the law of some states, creditors who have provided necessities to the beneficiary are spendthrift exception creditors.[21] The UTC omits necessities providers

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17. Dean Griswold said that ". . .the bundle of rights known as ownership of property does not embrace an unqualified power of disposition in any way desired. There is no syllogistic basis for the spendthrift trust. If such trusts are valid it is not because the owner of property may dispose of it as he sees fit, but because the particular restriction in question is not contrary to public policy." Erwin N. Griswold, *Spendthrift Trusts* (2d ed. 1947). With respect to Dean Griswold's arguments, it has been said that, "The settlor of a trust for another person should be allowed to insulate the assets and distributions of the trust from the beneficiary's creditors, but only up to a point. Some claims compel recognition on policy grounds." A. Emanuel, "Spendthrift Trusts: It's Time to Codify the Compromise," 72 *Nebraska L.Rev.* (1993). *See also* 2A Scott and Fratcher, *supra* n. 12, at §157-158.1; Restatement (Third) of Trusts § 58, Reporter's Notes cmt. a. (2001).

18. Unif. Trust Code § 503(b)(3) is narrower than the rule in the Second Restatement, which grants exception creditor status to the federal government and the State without regard to whether another state statute or federal law so provides.

19. Restatement (Second) of Trusts § 157(d) (1959) and Restatement (Third) of Trusts § 59 cmt. a(1) (2001).

20. *See* Unif. Trust Code § 503 cmt. (2005), "Subsection (c) provides that the only remedy available to an exception creditor is attachment of present or future distributions. Depending on other creditor law of the state, additional remedies may be available should a beneficiary's interest not be subject to a spendthrift provision. Section 501, which applies in such situations, provides that the creditor may reach the beneficiary's interest under that section by attachment or 'other means.' Subsection (c), similar to section 501, clarifies that the court has the authority to limit the creditor's relief as appropriate under the circumstances."

21. Restatement (Third) of Trusts § 59(b) cmt. c and Restatement (Second) of Trusts § 157(b).

as exception creditors.[22] Accordingly, this aspect of the UTC is more protective of SNTs with respect to creditor claims.[23]

D. The UTC preserves the distinction between support and discretionary trusts for most purposes.

Article 5 of the UTC, which contains the creditor remedy provisions, does not distinguish between discretionary and support trusts. Because of the lack of delineation, there has been commentary asserting that the UTC generally (i.e. for all purposes) eliminates the distinction between discretionary trusts and support trusts.[24] Some critics go even further and charge that under the UTC, the treatment of discretionary trusts will be the same as support trusts.[25] Nothing in the UTC supports these claims. Only in the official comment to §504 is any express reference made to the distinction between support trusts and discretionary trusts, and the comment makes it quite clear that the distinction has been eliminated only for creditor rights purposes. The comment to UTC §504, as amended in 2005, states:

> This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. . . . *Eliminating this distinction affects only the rights of creditors.* The effect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. (Emphasis added)

At one time, under the common law of most states, creditors could not compel distributions from discretionary trusts. For public policy reasons, however, in many jurisdictions judicially created exceptions to that rule evolved, or statutory exceptions were enacted, to permit judgments or court orders for child support, spousal support, or alimony to be satisfied from beneficial trust interests of the parent or spouse against whom the order was made, particularly where the trust contained a support standard. The UTC, in §504(c), merely codifies this very limited exception by granting to a small class of creditors the right to compel distributions *from discretionary trusts* under two limited circumstances: (i) where the trustee has not complied with a standard of distribution; or (ii) has abused its discretion. The discretionary-support

22. Unif. Trust Code § 503 cmts.

23. *See* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Trust J. (2005).

24. Merric, *et. al.*, in their article "The Uniform Trust Code: A Continued Threat to SNTs Even After Amendment," *supra*, n. 1, make the claim "The UTC specifically abolishes the discretionary support dichotomy."

25. Merric, *et. al.*, in their article "The Uniform Trust Code: A Continued Threat to SNTs Even After Amendment", *supra* n. 1, make the unsupported claim, "[T]he UTC redefines the discretionary trust to be nothing more than a support trust under common law. . . ." This claim appears to be a distortion of the Restatement (Third) of Trusts § 60 Reporter's Notes to cmt. a under which support trusts are treated as discretionary trusts with support standards. *See also infra* n. 33.

trust distinction no longer exists in this regard in states where child support or spousal support orders or judgments can be satisfied from the debtor-beneficiary's discretionary trust interest (and there are many such states).[26]

Because under the UTC the distinction between discretionary trusts and support trusts remains intact for all other purposes, the duties and rights of the trustee and the beneficiary with respect to distributions will continue to differ significantly if the trust is a discretionary trust or a support trust. Common law principles regarding discretionary trusts will continue to apply in determining trustee duties and the rights of beneficiaries.[27]

Of far more importance than UTC §504's recognition of the fact that for certain creditor rights purposes the distinction between support trusts and discretionary trusts has already been eroded by the courts, is §504(b)'s nearly complete bar against creditors, including governmental exception creditors, from being able to compel distributions from discretionary trusts.[28] Because of this bar, governmental entities that pay benefits to SNT beneficiaries simply lack the ability to reach assets held in an SNT. To clarify the point that the §504(b) bar against the ability to compel distributions applies only to creditors, §504(d) provides:

> This section *does not limit* [i.e. this section *does not create*] the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution. (Emphasis added)

Unfortunately, UTC critics assert that this unambiguous provision actually creates a new right in beneficiaries to compel distributions.[29] This language, which could hardly be stated more clearly, simply provides that any rights that a beneficiary may have under current state law to compel a distribution are not affected by the removal of creditors' rights to compel distributions. Under non-UTC law, many cases provide that where a beneficiary has the right to compel a distribution, so does the beneficiary's creditor.[30]

Why was the distinction between discretionary and support trusts removed for creditor rights purposes? Most trusts are neither purely discretionary trusts nor purely support trusts, but instead have elements of both. Because of that fact, a growing number of courts have refused to label trusts under review as being one type or

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26. *See e.g.*, Restatement (Third) of Trusts § 60 cmt. e(1) and Reporters Notes to cmt. e(1).
27. "Thus, while Article 5 treats discretionary trusts with and without support standards alike, it does not address or change the traditional rules that govern the trustee's exercise of discretion with respect to making distributions to or for the benefit of the beneficiary." Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, *supra*, n. 23.
28. Under §504, only spouses, former spouses, and children with support orders or judgments for support would be able to compel a distribution from a trust with a support standard, but only if the trustee improperly applied the standard or abused its discretion.
29. *See* § II(C)(2) of Merric, et. al. "The Uniform Trust Code: A Continued Threat to SNTs Even After Amendment," *supra* n. 1, in which they state "U.T.C. § 504 , titled 'discretionary trusts,' appears *to grant* a beneficiary an enforceable right to a distribution."
30. Restatement (Third) of Trusts § 60 cmt. (e); Clifton B. Kruse, Jr., *Third Party and Self Created Trusts—Planning for the Elderly and Disabled Client*, 55-61 (3d ed. 2002).

another, and instead base their decisions upon the intent of the settlor. The elimination of the dichotomy merely reflects what courts have already been doing.[31] A 1999 Iowa appellate decision[32] provides an excellent summary of the the problem:

> The definitional distinctions between support and discretionary trusts are limpid. Provisions of particular trusts muddy these clear demarcations. When the provision is equivocal or adheres to principles common to both types of trusts, interpretative inconsistencies abound. . . .
>
> Any attempt by this court to hammer the language of this particular trust provision into one of these rigid categories would only breed further inconsistencies in the law. . . . The state of Nebraska remedied the inherent inconsistencies of forcing equivocal trust provisions into traditional categories by creating a third category, a discretionary support trust, which addresses the equivocal provision in its entirety and best contemplates the intent of the settlor. . . . A discretionary support trust is created when the settlor combines explicit discretionary language 'with language that, in itself, would be deemed to create a pure discretionary trust. . . . The effect of a discretionary support trust is to establish the minimal distributions a trustee must make in order to comport with the settlor's intent of providing basic support, while retaining broad discretionary powers in the trustee. . . . The rationale behind minimal support lies in the trustee's fiduciary duties to the beneficiary. . . . If a trustee abuses her discretion and violates her fiduciary duties, the beneficiary, through judicial action, may compel disbursements from the trust for minimal support.
>
> A discretionary support trust harmonizes the seemingly inconsistent terms of the trust.

Professor Alan Newman, the Reporter for the Ohio Uniform Trust Code, has shared his observations regarding the elimination of the distinction, none of which gives credence to the claim that the elimination will make it easier for beneficiaries to compel distributions from discretionary trusts.[33]

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31. "Not only is the supposed distinction between support and discretionary trusts arbitrary and artificial, but the lines are also difficult - and costly - to attempt to draw. Attempting to do so tends to produce dubious characterizations and almost inevitably different results (based on fortuitous differences in wording or maybe a "fire side" sense of equity) from case to case for beneficiaries who appear, realistically, to be similarly situated as objects of similar settlor intentions." Restatement (Third) of Trusts § 60, Reporter's Notes on cmt. a. *See also* Restatement (Third) of Trusts § 50, Reporter's Notes on cmt. (e); Kruse, *supra*, n. 30, at 117-128.)
32. *Strojek v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566, 569 (Iowa Ct. App.1999).
33. *See* Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 *Real Prop. Prob. & Trust J.*, *supra*, n. 23, in which he states: "*Does the UTC treat a discretionary trust without a support standard as a trust for the beneficiary's support?* No. Although section 504 (prohibiting most creditors of the beneficiary from compelling discretionary distributions they can reach) and section 501 (providing creditors' remedies when the terms of the trust do not include a spendthrift provision) do not distinguish between discretionary trusts with and without support standards, with limited exceptions the UTC does not address the rights of beneficiaries – and the duties of trustees – with respect to distributions to be made from such trusts. Because the UTC generally does not address those subjects, they would be governed by common law and principles of equity. Thus, a beneficiary's right, if any, to receive a distribution from a discretionary trust, with or without a support standard, would be determined under the same rules under the UTC as it would be without the UTC. Under those rules, discretionary trusts without

Assuming, for the sake of argument, that in the context of creditor's rights the UTC does strip away all protections formerly enjoyed by a pure discretionary trust (such as a purely discretionary SNT with no distribution standard but with precatory SNT language), exactly what would be lost? Only two things:

a) Exception creditors[34] could attach, but not compel, present or future distributions that the trustee decides to make, subject to the court's ability to limit the award;[35] and

b) Spouses, former spouses, and children with support orders or judgments for support would be able to compel a distribution from a trust that contains a support standard if the trustee improperly applied the standard or abused its discretion.[36]

III. THE UTC WILL NOT MAKE IT EASIER FOR STATES TO DENY BENEFITS TO SNT BENEFICIARIES.

A. Beneficial interests in SNTs are not resources of their beneficiaries.

UTC critics charge that under the UTC, it will be easier for States to deny Medicaid benefits to SNT beneficiaries for the reason that the SNT assets will be treated as the beneficiaries' countable resources. While this claim is false, an examination of this issue hinges upon whether the beneficiary's interest in an SNT is a "resource." The answer as to whether or not an interest in a trust is a resource depends upon the terms of the trust (e.g., whether the trust contains a support standard) and upon whether or not the beneficiary has the right to compel a distribution.[37] As the UTC is generally silent regarding the rights that a beneficiary may have to compel a distribution[38], the issue ultimately boils down to whether or not the UTC has changed the judicial standard of review in a manner that would make it easier for a beneficiary to compel a distribution. All of these issues are discussed below.

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support standards are not treated as trusts for the beneficiaries' support." [Prof. Newman's footnotes have been omitted.]

34. The only 3 classes of exception creditors (i.e., those creditors against which spendthrift provisions are not effective) are listed in UTC § 503(b): (1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance; (2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and (3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.

35. Unif. Trust Code § 503(c).

36. *Id.*, at § 504(c).

37. The question of whether a trust is an available resource for qualification for government means-tested benefits (i.e., whether the beneficiary of the trust has the right to compel a distribution for support) is to be distinguished from the question whether the trust property is available to satisfy the beneficiary's creditors. *See Corcoran v. Dept. of Social Services*, 859 A2d. 533 (Conn. 2004).

38. *Supra*, n. 27.

The CMS State Medicaid Manual[39] has a detailed trust rule that applies to self-settled SNTs, but not to third party-settled SNTs. However, the State Medicaid Manual generally follows SSI rules for Medicaid, and most SSI recipients also qualify for Medicaid (and in many states SSI recipients automatically qualify for Medicaid).[40] Accordingly, as a general rule, an SNT will not be treated as a resource for Medicaid purposes to the extent that it does not make, and the beneficiary cannot compel the trustee to make, distributions for food and shelter.[41]

Nevertheless, in the eighteen States where Medicaid coverage is not automatically granted to SSI recipients (i.e. the SSI-criteria and §209[b] States), or for institutionalized individuals (institutionalized individuals are not eligible to receive SSI), state law will determine when an SNT is treated as a resource for Medicaid eligibility purposes. In most States, the legislatures or the Medicaid agencies have adopted statutes or rules governing when third party-settled SNTs will be treated as resources. These rules, however, must conform to the "availability" requirements set forth in the United States Code and the Code of Federal Regulations.

It is a fundamental principle of trust law that a grantor may dispose of his or her property in any manner desired, other than dispositions prohibited by law or contrary to public policy. Accordingly, if the settlor intends that the trust supplement rather than supplant the beneficiary's government benefits, such intent should be controlling. Such a trust should not be deemed an available resource.[42]

In an attempt to treat SNTs as available resources for Medicaid purposes, states occasionally have challenged SNTs (especially SNTs that do not clearly state their purpose of supplementing, rather than supplanting, public benefits) on the basis that the trustee owes an obligation of minimum support to the beneficiary.[43] On the other

39. The State Medicaid Manual provides operating policies and procedures to be followed by State Medicaid agencies. It can be found on the Internet at http://www.cms.hhs.gov/manuals/pub45pdf/smmtoc.asp.

40. *Supra*, n. 7.

41. *In re Leona Carlisle*, 498 N.W.2d 260 (Minn. App. 1993) (purpose to supplement and not to supplant public assistance); *Matter of Carmer*, 530 N.Y.S.2d 88 (Ct. App. 1988) ("personal and luxury items not supplied by the state"); *Stein v. Scott*, 625 N.E.2d 713 (Ill. App. 1993) (a discretionary trust that the court found was not intended to supplement other resources); *In re Wright's Will*, 107 N.W.2d 146 (Wis. 1961) (public policy does not prohibit a trust intended for luxuries not provided by the state), *Carnahan v. Ohio Dept. of Human Services*, 139 Ohio App. 3d 214 (2000) (a trust "expressly" for supplemental care).

42. *Young v. Ohio Dept. of Human Services*, 668 N.E.2d 908 (Ohio 1996).

43. *Bohac v. Graham*, 424 N.W.2d 144 (N.D. 1988) (support standard used and support could not be discretionarily withheld); *Bureau of Support in Department of Mental Hygiene and Correction v. Kreitzer*, 243 N.E.2d 83 (Ohio 1968) (sole and absolute discretion coupled with support standard is enforceable and creates an available resource); *Commonwealth Bank and Trust Co. v. Commonwealth of Penn.*, 598 A.2d 1279 (Pa. 1991) (discretionary support and maintenance deemed to be mandatory); *Matter of Estate of Dodge*, 281 N.W.2d 447 (Iowa 1979) (absent a grant of "unfettered or unlimited discretion" a discretionary trust for "care and maintenance" shows intent to support); *Kolodny v. Kolodny*, 503 A.2d 625 (Conn. 1986) (where support standard used, "discretion was not intended to be absolute" and is reviewable-trustee must distribute for support); *Kryzsko v. Ramsey Cty. Social Services*, 607 N.W.2d 237 (N.D. 2000) (no reference to an intention to limit distributions to supplemental benefits); *In re Lackmann's Estate*, 320 P.2d 186 (Cal. 1958)

hand, there are cases in which trusts that contain an express support standard, but that also grant to the trustee uncontrolled discretion, have been held not to be available resources.[44] As a general rule, purely support trusts are treated as available resources; but, purely discretionary trusts are rarely available resources. The difference typically hinges upon whether or not under state law the beneficiary has the right to compel a distribution for support.[45]

B. When can a beneficiary compel a distribution?

The answer to this question is important, because in most states a trust will be treated as a resource if the beneficiary can compel a distribution, especially a distribution for support.[46] Unfortunately, the UTC is silent on this important question. There are 3 important points to make regarding this question that do involve the UTC.

First, while §504 does prohibit creditors from being able to compel distributions, paragraph (d) of that section does not limit the beneficiary's right to maintain an action against the trustee for abuse of discretion or failure to comply with a standard of distribution. Section 504(d) does not grant the beneficiary a new right to compel distributions. Rather, it merely states that the §504 ban on the ability of creditors to compel distributions is independent of the ability of beneficiaries to compel distributions when the trustee has abused its discretion or failed to comply with a

(complete and absolute discretion coupled with a support standard is an enforceable interest subject to a claim for hospital care); *Estate of Rosenberg v. Dept. of Public Welfare*, 644 A.2d 215 (Pa. Commw. 1994), *aff'd*, 679 A.2d 767 (Pa. 1996) (intent to provide medical expenses without relying on public assistance); *Sisters of Mercy Health v. First Bank*, 624 N.E.2d 520 (Ind. App. 1993) (although not a public benefits case, discretion was abused by failing to pay for medical expenses); *Corcoran v. Dept. Social Services, supra*, n. 37 (manifestation of intent to create a trust to support in "reasonable comfort" distinguishing facts in *Zeoli v. Commissioner of Social Services*, 425 A.2d 553).

44. *Alabama Medical Agency v. Primo*, 579 So.2d 1355 (Ala. Civ. App. 1991) (recognizing importance of POMS SI 01120.105 A.2 (1981); *City of Bridgeport v. Reilly*, 47 A.2d 865 (Conn. 1946) (a reasonable exercise of discretion is not reviewable); *Chenot v. Bourdeleau*, 561 A.2d 891 (R.I. 1989) (an amalgamation of support and discretionary trust terms but discretionary trust terms control; discretion cannot be forced so long as the trustee acts in "good faith"); *First Nat'l Bank of Md. v. Dept. of Health*, 399 A.2d 891 (Md.1979) (discretionary trust with support standards but because of use of "absolute and uncontrolled" in defining discretion, the trust was not an available resource); *Lang v. Commonwealth Department of Public Welfare*, 528 A.2d 1335 (Pa. 1987) (discretionary support trust held to be supplemental); *Lineback v. Stout*, 339 S.E.2d 203 (N.C. 1986) (a discretionary support trust may be construed as a supplemental care trust); *Myers v. Kansas Dept. of Social Services & Rehab.*, 866 P.2d 1052 (Kan. 1994) (a discretionary trust with standards not available because trustee could decline to pay for medical care and assistance); *Department of Mental Health v. Phillips*, 500 N.E.2d (Ill. 1986) (no discretion to make payments that would render beneficiary ineligible); *Matter of Sykes*, 345 N.W.2d 642 (Mich. App. 1983) (discretionary support trust coupled with duty to consider other resources is not available); *Zeoli v. Commissioner of Social Services, supra*, note 43 (discretionary support trust coupled with precatory language to consider other resources makes the trust supplemental); *Tidrow v. Director, Missouri State Div. of Family Services*, 688 S.W.2d 9 (Mo. App. 1985) (a discretionary support trust intended for supplemental benefit is "not actually available" and will not disqualify).

45. Kruse, *supra* n. 30, at 54.

46. *Corcoran v. Dept. of Social Services*, *supra* n. 37.

standard of distribution.[47] Whether or not a beneficiary has such a right is dependent upon existing state law. §504 creates no new right.

Second, as stated above, §504(b) explicitly prohibits most creditors of a beneficiary from compelling discretionary distributions, even distributions that the beneficiary might be able to compel. Because that prohibition is not conditioned on the beneficiary being unable to compel distributions because of an abuse of discretion, the rights, if any, the beneficiary may have to compel distributions have no effect on most creditors' inability to do so.

Third, under UTC §502(c), if the terms of the trust include a valid spendthrift provision, creditors (other than exception creditors) may not reach the beneficiary's interest, or the trust assets, before their receipt by the beneficiary from a distribution by the trustee, even if the state law gives the beneficiary a right to compel discretionary distributions (or even if a beneficiary has a mandatory right to receive distributions).[48]

C. Common law rights to compel distributions.

If a trust is a pure discretionary trust with no distribution standard, the beneficiary generally has no ability to compel a distribution, especially if the trustee was given "sole," "absolute," or "uncontrolled" discretion.[49] Therefore the trust is not an available resource.[50]

If a trust is a support trust, a beneficiary generally has the right to compel the trustee to make distributions pursuant to the distribution standard.[51] Accordingly, the trust is an available resource.[52]

There has been much litigation on the issue of whether or not a trust is a support trust. If the trust is discretionary with a support standard, some cases have held that the beneficiary cannot compel a distribution. In these cases, the trust property is not an available resource and the beneficiary is not disqualified from eligibility of means-tested government benefits. Other cases have held that the beneficiary can compel a distribution and that the trust property is therefore an available resource.[53] The

47. *See* Unif. Trust Code § 504 cmt. to subsection (d): "... the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary. Under UTC § 814(a), a trustee must always exercise discretionary power in good faith and with regard to the purposes of the trust and the interest of the beneficiaries."

48. *See* Unif. Trust Code § 502 cmt which provides: "Unless one of the exceptions under this article applies, a creditor of the beneficiary is prohibited from attaching a protected interest and may only attempt to collect from the beneficiary after the payment is made." *See also* Restatement (Third) of Trusts § 58 and Restatement (Second) of Trusts §§ 152-153.

49. Restatement (Third) of Trusts § 50 cmt. b., Reporter's Notes to cmts. a-b; Restatement (Second) of Trusts § 187; 2A Scott and Fratcher, *supra*, n. 12, §§ 128.3-128.7; George G. Bogert and George T. Bogert, *The Law of Trusts and Trustees* §§ 182, 228-230, 424-428, 811 (rev. 2d.ed. 1979).

50. *Simpson v. Kansas Dept. of Social and Rehabilitation Services* 906 P.2d 174 (C.A. 1995).

51. *See* Restatement (Third) of Trusts § 50 and Restatement (Second) of Trusts § 187.

52. *Nason v. Commonwealth of Penn.*, 520 A.2d 1223 (Penn. Commw. 1987). *See also Kruse, supra*, n. 30, at 55-61.

53. *See Kruse, supra*, n. 30, at 54 - 70.

question becomes one of settlor intent, to wit: does the settlor demonstrate an intent to supplement the beneficiary's public benefits or an intent to supplant them?[54] The Comment to UTC §103 underscores the point that it is the settlor's intent that is paramount. That comment states, "Except as limited by public policy, the extent of a beneficiary's interest is determined solely by the settlor's intent."

Intent is evidenced primarily by the trust's distributive language, but it can also be determined by precatory statements, and the circumstances of the beneficiary at the time of the trust's creation.[55] This is illustrated in *In Re Leona Carlisle Trust*,[56] where the court stated:

> The intention of the settlor of the trust will be carried out if it is not contrary to law and public policy.... When the trust instrument states an intent to supplement rather than supplant any government financial assistance that is or may be available to the Medicaid recipient, most courts give effect to the settlor's intent and find the trust is not an available asset.... The cases that involve both a discretionary trust and clear settlor intent to supplement rather than supplant government assistance conclude the trust is not an available assets. See id. [*Trust Co. of Okla.*, 825 P.2d 1295], see also *Zeoli v. Commissioner of Social Servs.*, 179 Conn. 83 (1979); *Lineback by Hutchens v. Stout*, 79 N.C.App 292 (1986).

Many cases, however, are notable for the fact that no examination is made regarding the settlor's intention in creating the trust.

D. A beneficial trust interest cannot be a resource unless it is "available."

To determine whether a person is entitled to Medicaid benefits, a state may consider only the income and resources that are "available" to the applicant or recipient. Whether an interest in a trust is a "resource" is a matter of federal law, and while the meaning of "availability" in the context of a third party-settled trusts is not specifically addressed in the United States Code or the Code of Federal Regulations, that issue is addressed squarely in the CMS Program Operation Manual System ("POMS"), and was discussed in the legislative history of the Medicaid Act.

42 U.S.C. 1396a requires: "A State plan for medical assistance must...(17)... include reasonable standards...for determining eligibility...which... (B) provide for taking into account only such income and resources as are, as determined in accordance with standards prescribed by the Secretary, *available to the beneficiary* [and]...(C) provide for reasonable evaluation of any such income or resources...." (emphasis added)

20 CFR §416.1201(a)(1) clarifies this by providing:

> (a) Resources; defined. For purposes of this subpart L, resources means cash or other liquid assets or any real or personal property that an individual (or spouse, if any) owns and could convert to cash to be used for his or her support and

54. *See Kruse, supra*, n. 30, at 55 – 58.

55. *See First National Bank of Maryland v. Dept. of Health and Mental Hygiene, supra*, n. 44; *see also Tidrow v. Director, Missouri St. Div. of Family Serv., supra*, n. 44.

56. 498 N.W.2d 260 (Minn. Ct. App. 1993).

> maintenance. (1) If the individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource. If a property right cannot be liquidated, the property will not be considered a resource of the individual (or spouse).

Similarly, 20 CFR §416.120(c)(3) states, "Resources means cash or other liquid assets or any real or personal property that an individual owns and could convert to cash to be used for support and maintenance. . . ."

The POMS, at SI 01120.200, discusses "availability" in the context of trusts established by third parties. (D)(1)(a) of that section states:

> If an individual (claimant, recipient, or deemor) has legal authority to revoke the trust and then use the funds to meet his food, clothing or shelter needs, or if the individual can direct the use of the trust principal for his/her support and maintenance under the terms of the trust, the trust principal is a resource for SSI purposes.

The issue of "availability" is also discussed in Medicaid's legislative history. A 1965 Senate Report summarizing the newly enacted Medicaid Act stated:

> Another provision is included that requires States to take into account only such income and resources as. . .are actually available to the applicant or recipient and as would not be disregarded. . . . Income and resources taken into account, furthermore, must be reasonably evaluated by the States. These provisions are designed so that the States will not assume the availability of income which may not, if fact, be available or overevaluated income and resources which are available.[57]

State and federal courts have addressed the application of these federal "availability" requirements. The United States Supreme Court has stated that the "availability principle" is aimed primarily at preventing states from imputing or assuming financial assistance from sources who have no obligation to furnish it.[58] The Connecticut Supreme Court stated:

> [U]nder applicable federal law, only assets *actually available to a medical assistance recipient* may be considered by the state in determining eligibility for public assistance programs such as title XIX [Medicaid]. . . . A state may not, in administering the eligibility requirements of its public assistance program pursuant to title XIX . . . presume the availability of asset not actually available. . . . *Zeoli v. Commissioner of Social Services,* 179 Conn. At 94, 425 A.2d 553.[59]

E. Effect of the Mandatory Good Faith Standard on "Availability."

UTC §814(a) provides: "Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as 'absolute', 'sole', or 'uncontrolled', the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries." This is one of the 14 mandatory rules of UTC §105 that cannot be

57. S.Rep. No. 404, 89th Cong., 1st Sess. 78 (1965)

58. *Schweiker v. Gray Panthers*, 453 U.S. 34, 101 S.Ct. 2633 (1981).

59. *See also Corcoran v. Dept. of Social Services, supra,* n. 37, and Kruse, *supra,* n. 30, pgs. 52 – 54.

changed by the settlor. If, in fact, §814(a) enhances beneficiaries' rights to compel distributions from discretionary trusts, state Medicaid agencies would correspondingly be able to treat more, but certainly not all, discretionary trusts as available resources. Fortunately, §814(a) provides no such enhancement. Even if §814(a) did grant beneficiaries a greater ability to compel distributions, which it does not, a beneficiary would still be unable to compel a distribution from a pure discretionary trust without a support standard or from a discretionary trust that states its purpose as being to supplement rather than to supplant public benefits.

The claim has been made that §814(a) creates a much higher standard for trustee conduct inasmuch as it replaces the current "bad faith" standard.[60] Requiring "good faith" appears to be the same standard as one that prohibits "bad faith." Just as there are a plethora of cases that state the judicial standard of review is a good faith[61], a significant numbers of cases state that the standard of review is based upon an abuse of discretion or bad faith standard.[62] While these cases frame the standard differently, the effect of their holdings is the same, simply because the standards are the same. Critics have been unable to cite even one case that contrasts the good faith standard from the abuse of discretion standard for the simple reason that no such case exists. In point of fact, the inclusion of §814(a) is just another instance of the UTC's codification of current trust law. Without changing the meaning, that section could have instead prohibited trustees from exercising discretionary powers in bad faith, or it could have been omitted altogether. Inasmuch as a primary purpose of the UTC is the codification of the common law of trusts, its inclusion, as written, is an accurate reflection of the common law of trusts. The fact that a good faith standard is, and for many decades has been, the same as a standard that prohibits bad faith is illustrated by *Sylvester v. Newton,*[63] where the court stated:

> It has been long established as matter of law that the judgment of this court cannot be substituted for the discretion conferred upon fiduciaries *fairly, reasonably, and honestly exercised* [cites omitted]. The court will substitute its discretion only when that is necessary to prevent an *abuse of discretion* [cites omitted]. In the instant case the only question is whether the exercise of discretion by the executor complained of was arbitrary, capricious and *not in good faith.* [emphasis added]

60. *See* Merric, *et. al.*, "The Uniform Trust Code: A Continued Threat to SNTs Even After Amendment," *supra,* n. 1.

61. *Friedman*, 844 S.2d 789; *United States v. O'Shaughnessy, supra,* n. 15; *Jacob v. Davis*, 738 A.2d 904 (Md. Ct. App. 1999); *NationsBank of Virginia, N.A. v. Estate of Grandy*, 450 S.E.2d 140 (Va. 1994); *In re Ternansky's Estate*, 141 N.E.2d 189 (Ohio Ct. App. 1957); *Matter of Estate of Mayer*, 672 N.Y.S.2d 998 (N.Y. Sur. 1998).

62. *Marriage of Jones, supra,* n. 14; *Goodwine v. Goodwine*, 819 N.E.2d 824 (Ind. Ct. App. 2004); *Jennings v. Murdock*, 553 P.2d 846 (Kan. 1976); *Amer. Cancer Soc., St. Louis Div. v. Hammerstein*, 631 S.W.2d 858 (Mo. Ct. App. 1981); *In re Goodman*, 790 N.Y.S.2d 837 (N.Y. Sur. 2005); *Finch v. Wachovia Bank & Trust Co., N.A.*, 577 S.E.2d 306 (N.C. Ct. App. 2003); *Robinson v. Kirbie*, 793 P.2d 315 (Okla. Ct. App. 1990).

63. 321 Mass. 416, 73 N.E.2d 585 (1947).

Professor Alan Newman has also pointed out that courts use the terms "bad faith" and "good faith" interchangeably because the former is essentially the absence of the latter.[64] In support of his conclusions he cites a California case in which the court said:

> . . .the 'sole discretion' vested in an exercise by the trustees in this case. . .were exercised fraudulently, in bad faith or in an abuse of discretion, in other words an abuse of discretion, it is subject to. . .review. Whether good faith has been exercised, or whether fraud, bad faith or an abuse of discretion has been committed it is always subject to consideration by the court upon appropriate allegations and proof. *In Re: Ferrall's Estate* 258 P.2d 1009 (Cal. 1953).

Professor Newman drives home this point by comparing two recent Colorado cases:

> Further, a year after the Colorado Supreme Court stated that if the settlor gives the trustee uncontrolled discretion, the court will not interfere with its exercise unless the trustee "acts dishonestly or from an improper motive, or fails to use his judgment," [fn: *Marriage of Jones*, 812 P.2d at 1156. Note that in *Jones*, the Colorado Supreme Court did not announce a single standard to be applied in Colorado in cases involving a challenge to the trustee's exercise of discretion. In fact, the case did not even involve such a challenge, but instead decided whether a wife's interest in a discretionary trust constituted property for purposes of division in a divorce. *Id.* In holding that it did not, the court described the circumstances under which a trustee's exercise of discretion will be reviewed in four different ways: (i) "the beneficiary could not force the trustee to pay income or principal unless she could establish fraud or abuse of discretion," *id.* at 1156; (ii) "[t]he beneficiary cannot obtain the assistance of the court to control the exercise of the trustee's discretion except to prevent an abuse by the trustee of his discretionary power," *id.*; (iii) "*[i]f the settlor manifested an intention that the discretion of the trustee should be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment*," *id.* (emphasis in original), and (iv) "the beneficiary of a discretionary trust has no contractual or enforceable right to income or principal from the trust, and cannot force any action by the trustee unless the trustee performs dishonestly or does not act at all." *Id.]* a lower appellate court in Colorado decided a case in which a trustee with sole and absolute discretion over distributions also was a remainder beneficiary and thus had a conflict of interest with respect to his exercise of discretion. [fn: *See In re Estate of McCart*, 847 P.2d 184 (Colo. Ct. App. 1992).] In upholding the income beneficiary's claim for increased distributions from the trust, the opinion characterized the trustee's conduct as an abuse of discretion, arbitrary and capricious, improperly motivated, and a "breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward the beneficiary [fn: *id.*]

Scott and Fratcher, in *The Law of Trusts*, equate an abuse standard to a good faith standard. "To the extent . . . the trustee has discretion . . . [t]he court will not substitute its own judgment for his . . . however the court will not permit him to *abuse the discretion*. This ordinarily means that so long as he acts not only in *good faith* and from proper motives, but also within the bounds of a reasonable judgment, the court

64. *See* Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 *Real Prop. Prob. & Trust J. supra*, n. 23.

will not interfere."[65] Moreover, at section 187.2, Professors Scott and Fratcher, in their treatise, note that while the "reasonableness" standard can be waived, when it is waived, the "good faith" standard still applies.

Bogert and Bogert, in *The Law of Trusts and Trustees*, make similar observations. The discussion on judicial standards of review is contained in §560, where "simple" discretion is distinguished from "absolute" discretion, which is discretion described as "full," "complete," "absolute," or "uncontrolled." Where absolute discretion is granted to the trustee, Bogert and Bogert observe, "Notwithstanding the fact that a literal interpretation of these grants of absolute and uncontrolled discretionary power would seem to sanction any action taken by the trustee thereunder and to leave the courts powerless to intervene, such a construction has not been given them. . . . Although he gives his trustee great freedom of action in the administration of the trust, he surely must intend the qualification that the trustee shall act with some regard to the purposes of the trust and not make decisions which frustrate the accomplishment of the settlor's intent, and that he employ his discretion deliberately and with some thought and not recklessly or capriciously *but in a spirit of good faith and honesty.*" [emphasis added].

Bogert and Bogert also observe that where the trustee is granted absolute discretion, two standards have been used in determining whether the court will review a trustee's exercise of his absolute discretion. One standard permits judicial review where the trustee acted in bad faith, dishonestly, or some other improper motive. Under this standard the trustee's discretion need not be exercised reasonably. Under the second standard, notwithstanding the grant of absolute discretion, the trustee's exercise of that discretion must be reasonable under the circumstances. Under both, "There is agreement that a trustee must act in good faith. . ." Bogert and Bogert state, "It may be concluded that the only difference in the attitude of the courts with regard to mere discretionary powers and absolute discretionary powers is one of degree, in that they are more easily persuaded to find an abuse of a mere discretionary power than to find an improper use of an absolute or uncontrolled power." Compare this with the official comment to UTC Sec. 814:

> A grant of discretion establishes a range within which the trustee may act. The greater the grant of discretion, the broader the range. . . . Subsection (a) requires a trustee to exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to *Restatement (Second) of Trusts* Section 187, subsection (a) does not impose an obligation that a trustee's decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee's judgment can be tested. *Restatement (Second) of Trusts* Section 187 cmt. f [sic; should be i]

Thus, it is doubtful that requiring good faith is substantively different than prohibiting bad faith. It would, therefore, seem that even if §814 places a higher standard on trustees, a grant of extended discretion to the trustee [e.g. "sole" and "absolute"] by the grantor combined with a statement in the trust instrument regarding

65. 2 Scott and Fratcher, *supra*, n. 14, § 187.

the non-support nature of the trust should combine to defeat easily any attempts by the beneficiary to compel a distribution.

IV. THE UTC DOES NOT GIVE THE GENERAL CREDITORS OF AN SNT BENEFICIARY ENHANCED RIGHTS.

A. The UTC actually lessens the ability of general creditors to compel distributions.

Under UTC §504(b), general creditors have lost any ability that they may have had to compel distributions.[66] There are reported cases from at least nineteen states[67] in which creditors have been permitted to compel distributions from discretionary trusts. When this has been permitted, the creditor typically has provided support on behalf of a beneficiary of a trust with a support standard where it would have been an abuse of discretion by the trustee to refuse to pay for the support.[68] UTC section 504, however, prohibits most creditors from being able to compel distributions, even where the creditor has provided support to or for a beneficiary of a support trust, thereby effectively overruling these decisions.[69]

66. Compare *Estate of Dodge, supra,* n. 43 (abuse of discretion for trustee not to invade principal of trust created for beneficiary's "maintenance and care" to satisfy creditor claim for support); *State v. Rubion* 308 S.W.2d 4 (Tex. 1957) (abuse of discretion for trustee of discretionary support trust to refuse to pay anything to the state for necessary care). *See also* Restatement (Third) of Trusts § 60 Reporter's Notes to cmt. e.

67. 2 Scott and Fratcher, *supra,* n. 14, §157.2 at n. 10, lists cases from California, Colorado, Connecticut, Illinois, Massachusetts, Michigan, Missouri, Montana, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, and Vermont in which this remedy has been permitted. This remedy was also permitted in Ohio in *Bureau of Support in Department of Mental Hygiene and Correction v. Kreitzer, supra,* n. 43.

68. *Estate of Dodge, supra,* n. 43; *State v. Rubion, supra,* note 66; *Bureau of Support in Department of Mental Hygiene and Correction v. Kreitzer, supra,* n. 43; Restatement (Third) of Trusts § 60 Reporter's Notes to cmt. e(1).

69. Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code,* 40 *Real Prop. Prob. & Trust J. supra,* n. 23. (Professor Newman states: "Section 504(b) prohibits most creditors from compelling a distribution 'that is subject to the trustee's discretion.' If the terms of the trust require distributions for support (for example, 'the trustee shall make distributions of income and principal for the beneficiary's support'), an argument can be made that the prohibition of section 504(b) is not applicable, because the required support distributions arguably would not be subject to the trustee's discretion within the meaning of section 504(b). For at least four reasons, such an argument would fail. First, section 504(b)(1) makes the general rule applicable to discretionary distributions 'even if. . .the discretion is expressed in the form of a standard of distribution.' Thus, the use of a standard of distribution in the terms of the trust is treated by the statute as a grant of discretion over distributions. Second, the comment to section 504 notes that the section does not distinguish between support and discretionary trusts and refers to a provision in the Third Restatement under which support trusts are treated as discretionary trusts with support standards. Third, if such terms – 'the trustee shall make distributions of income and principal for the beneficiary's support' – are not treated as providing for distributions at the trustee's discretion, presumably they would have to be treated as calling for mandatory distributions. . . .however, the 2005 amendments to the UTC explicitly define mandatory distributions to exclude distributions pursuant to a standard. Fourth, the comment to section 506, as

B. SNTs do not need creditor protection in order to fulfill their intended purpose.

While the UTC actually limits, rather than expands, the rights of most creditors,[70] the fact remains that the primary purpose of an SNT is to serve as a vehicle that will provide for the supplemental needs of a disabled beneficiary without affecting the beneficiary's eligibility for governmental benefits.

Absent State law to the contrary, the OBRA self-settled SNTs never have had any asset protection features, yet they have been able to fulfill their intended purpose despite that fact. Inclusion of a spendthrift provision would be ineffectual in a self-settled SNT, since they are funded with the beneficiary's assets.[71] UTC §505 merely codifies the prevailing common law rule in this regard: "With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit."[72]

Under the UTC, third party settled SNTs will enjoy the full degree of protection from the beneficiary's general creditors that they have traditionally had.

V. SUMMARY.

In conclusion, the UTC will not negatively affect SNTs. The UTC will not permit lifetime or postmortem recovery by state governments from SNTs for benefits paid to their beneficiaries. Because of mandatory statutory federal safeguards, the UTC will not assist states in their efforts to deny public benefits to SNT beneficiaries. The UTC will not give general creditors of beneficiaries of self-settled or third party-settled SNTs greater rights than they may already have. The UTC will actually enhance SNT planning because of the Section 504 prohibition against the ability of creditors to compel distributions. Planning is further enhanced by Section 503's removal of exception creditor status for creditors who provided necessary services or supplies, and the inclusion in both Sections 501 and 503 of the Court's ability to limit a creditor's award to such relief as is appropriate under the circumstances. The need for a codification of trust law is obvious. The ABA and a large and growing number of state bar associations, have endorsed the UTC and, as of October 1, 2005, it has been enacted in fifteen States. A critical analysis shows that the UTC is not a threat to SNTs.

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amended in 2005, explicitly states that a trust is discretionary even if it includes 'a provision directing a trustee to pay for a beneficiary's support.' [citations omitted.])

70. UTC § 504(b) prohibits most creditors (including creditors who have provided support) from forcing exercise of discretion even if there has been abuse); and UTC §503 eliminates the common law necessities provider from spendthrift protection status.

71. Unif. Trust Code § 505; *See also* Restatement (Third) of Trusts § 58(2) and cmt. c. and Restatement (Second) of Trusts § 156.

72. *Ware v. Gulda*, 117 N.E.2d 137 (Mass. 1954) (creditors of a settlor/beneficiary may reach the assets of the self-settled trust, discretionary spendthrift trust); *In re: Cohen*, 8 P.3d. 429 (Colo. 1999) (where a person creates a spendthrift trust for his own benefit, his transferee or creditors can reach his interest, and where a person creates a support or discretionary trust for his own benefit, his transferee or creditors can reach the maximum amount that the trustee could pay to him or apply for his benefit; citing Restatement (Second) of Trusts § 156) *See also* Restatement (Third) of Trusts § 60 cmt. f and Restatement (Third) of Trusts § 58(2) and cmt. e.

APPENDIX A

OHIO MODIFICATIONS TO THE UTC THAT PROTECT SNTS

This appendix lists several modifications made in the Ohio Uniform Trust Code ("OUTC," not enacted) that should have the effect of providing additional protection to SNTs. There can be no question but that under the OUTC, SNTs would have enhanced protections not available under current law.

The Ohio UTC Joint Committee (Joint Committee) is composed of the members from the Ohio State Bar Association's Estate Planning, Trust and Probate Law Section and the Ohio Banker's League. The Ohio Association of Probate Judges and the Elder Law Committee of the Ohio State Bar Association also provided input. The UTC has not yet been introduced in the Ohio legislature; however, that step is anticipated prior to the publication of these materials. Representing such a diverse group of interests, early in the process the Joint Committee decided to study creditor remedies that currently existed against beneficial trust interests and to determine any differences between current Ohio law and the UTC. After a report on creditor rights was prepared and discussed, the decision was made that, with only few exceptions, Ohio would modify Article 5 of its version of the UTC to codify existing Ohio trust law in the area of creditor rights, rather than change it.

Many more modifications were made than are listed below. Those described in this appendix were made to help protect SNTs, or have the effect of providing additional protection to trust beneficiaries in general. While some of these "protections" are most likely not needed, they nevertheless serve the purpose of removing potential uncertainty in key areas by maintaining the status quo and, in some cases, by affording more protections than are available either under current law or under the final version of the UTC. Certain portions of the OUTC that are quoted below show modifications made by the Joint Committee to the corresponding UTC provision. Other quoted sections of the OUTC are intended to highlight additions made by the Joint Committee that add significant protections for SNTs.

A second factor that needs to be noted is the fact that Ohio, having no official "legislative history," does not allow for official comments. Some substantive material that appears in the UTC comments was moved into the text of the OUTC to help assure the intended result.

I. THE "WHOLLY DISCRETIONARY TRUST"

The Joint Committee determined the protection afforded beneficiaries of common law pure discretionary trusts to be significant. While it is the feeling of the authors that those protections are not lost under the UTC, the Joint Committee, in keeping with its goal of codifying, but not changing, Ohio's trust law in the area of creditor remedies, proposed the creation of a statutory safe harbor pure discretionary trust. In the proposed OUTC, this trust is referred to as a "wholly discretionary trust" ("WDT"). The benefit of having the status of a WDT is that none of the remedies in

Article 5 of the UTC are available to creditors of the WDT's beneficiary. Of potentially critical importance to SNTs, the WDT definition does permit precatory language regarding the intended purpose of the SNT.

A. Definition of WDT - § 5801.02(Y)

(Y)(1) "Wholly discretionary trust" means a trust to which all of the following apply:

(a) The trust is irrevocable.

(b) Distributions of income or principal from the trust may be made to or for the benefit of the beneficiary only at the trustee's discretion.

(c) The beneficiary does not have a power of withdrawal from the trust.

(d) The terms of the trust use "sole," "absolute," "uncontrolled," or language of similar import to describe the trustee's discretion to make distributions to or for the benefit of the beneficiary.

(e) The terms of the trust do not provide any standards to guide the trustee in exercising its discretion to make distributions to or for the benefit of the beneficiary.

(f) The beneficiary is not the settlor, the trustee, or a cotrustee.

(g) The beneficiary does not have the power to become the trustee or a cotrustee.

(2) A trust may be a wholly discretionary trust with respect to one or more but less than all beneficiaries.

(3) If a beneficiary has a power of withdrawal, the trust may be a wholly discretionary trust with respect to that beneficiary during any period in which the beneficiary may not exercise the power. During a period in which the beneficiary may exercise the power, both of the following apply:

(a) The portion of the trust the beneficiary may withdraw may not be a wholly discretionary trust with respect to that beneficiary;

(b) The portion of the trust the beneficiary may not withdraw may be a wholly discretionary trust with respect to that beneficiary.

(4) If the beneficiary and one or more others have made contributions to the trust, the portion of the trust attributable to the beneficiary's contributions may not be a wholly discretionary trust with respect to that beneficiary, but the portion of the trust attributable to the contributions of others may be a wholly discretionary trust. If a beneficiary has a power of withdrawal, then upon the lapse, release, or waiver of the power, the beneficiary is treated as having made contributions to he trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greatest of the following amounts:

(a) The amount specified in section 2041(b)(2) or 2514(e) of the Internal Revenue Code;

(b) If the donor of the property subject to the beneficiary's power of withdrawal is not married at the time of the transfer of the property to the trust, the amount specified in section 2503(b) of the Internal Revenue Code;

(c) If the donor of the property subject to the beneficiary's power of withdrawal is married at the time of the transfer of the property to the trust, twice the amount specified in section 2503(b) of the Internal Revenue Code.

(5) Notwithstanding divisions (Y)(1)(f) and (g) of this section, a trust may be a wholly discretionary trust if the beneficiary is, or has the power to become, a trustee only with respect to the management or the investment of the trust assets, and not with respect to making discretionary distribution decisions. With respect to a trust established for the benefit of an individual who is blind or disabled as defined in 42 U.S.C. § 1382c(a)(2) or (3), as amended, a wholly discretionary trust may include either or both of the following:

(a) Precatory language regarding its intended purpose of providing supplemental goods and services to or for the benefit of the beneficiary, and not to supplant benefits from public assistance programs;

(b) A prohibition against providing food, clothing, and shelter to the beneficiary.

B. Mandatory Good Faith Standard - UTC §814(a) and OUTC §5808.14(A)

UTC § 814(a) provides that a trustee must exercise discretionary powers reasonably and "in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries," regardless of whether the trust instrument describes the trustee's discretion as, for example, "absolute," "sole," or "uncontrolled." For wholly discretionary trusts, OUTC § 5808.14(A) provides that a reasonableness standard shall not apply.

5808.14

(A) The judicial standard of review for discretionary trusts is that the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries, except that a reasonableness standard shall not be applied to the exercise of discretion by the trustee of a wholly discretionary trust. The greater the grant of discretion by the settlor to the trustee, the broader the range of permissible conduct by the trustee in exercising it.

C. Statutory Elimination of Remedies Against the WDT - OUTC § 5805.03

While the proposed statutory definition and judicial standard of review may be sufficient to give WDTs the complete creditor protection that pure discretionary trusts (i.e. discretionary trusts with no distribution standards) enjoyed under the common law, the OUTC has added a new section, § 5805.03, to make absolutely clear the fact that the Article 5 remedies are not available against interests in WDTs. As Ohio generally does not provide for the judicial sale of discretionary interests, even in the absence of a spendthrift provision, that lack of remedy was codified in the new section:

5805.03 Wholly discretionary trusts.

Notwithstanding section 5805.02(B) of the Revised Code, no creditor or assignee of a beneficiary of a wholly discretionary trust may reach the beneficiary's interest in the trust, or a distribution by the trustee before its receipt by the beneficiary, whether by attachment of present or future

> distributions to or for the benefit of the beneficiary, by judicial sale, by obtaining an order compelling the trustee to make distributions from the trust, or by any other means, regardless of whether the trust instrument includes a spendthrift provision.

D. How a WDT Might Read

The WDT should work well as a SNT. In keeping with the purely discretionary common law trust, a WDT is prohibited from having any type of distribution standard. A limited exception permits precatory language for SNTs regarding the special needs nature of the trust. The inclusion of such precatory language in a WDT could be important to dispel any argument that the trustee can be required to make distributions for the support of the beneficiary. The distribution standard for a WDT-SNT, with precatory language, could be as follows:

> The trustee may distribute to, or use for the benefit of, the beneficiary such amounts, or none, of income or principal as the trustee, using sole, absolute and uncontrolled discretion, may determine. The beneficiary is disabled and will rely on public programs for much of her life. I will not always be there to help her and oversee her care. I know that she will have supplemental and special requirements, including a need for advocacy, which will not be provided by the publicly funded programs. It is my desire, but not my direction, that the trustee, in the exercise of the trustee's sole and uncontrolled discretion, make distributions which permit the beneficiary dignity and grace, enhance the beneficiary's day to day existence, and allow her the highest possible development of her abilities in a manner that will not jeopardize her eligibility for public benefits. (modified from a distribution standard provided by Cynthia L. Barrett, CELA, of Portland, OR)

II. MANDATORY DISTRIBUTIONS

A. Definition of "Mandatory Distribution" - UTC § 506(a) and OUTC § 5801.02(M)

Prior to the 2005 Amendments to the UTC, "mandatory distribution" was not a defined term, at which time a definition of that term was added to UTC § 506(a). The Ohio definition of "mandatory distributions" is included in the definitional section, OUTC § 5801.02 (which corresponds to UTC § 103) and differs from the UTC definition primarily to state explicitly that a distribution pursuant to a support standard is not a "mandatory distribution" even if the trustee is directed to make support distributions and the trust instrument does not expressly grant the trustee discretion with respect to such distributions.

OUTC 5801.02

> (M) "Mandatory distribution" means a distribution of income or principal, including a distribution upon termination of the trust that the trustee is required to make to a beneficiary under the terms of the trust. Mandatory distributions do not include distributions that a trustee is directed or authorized to make pursuant to a support or other standard, regardless of whether the terms of the trust provide that the trustee "may" or "shall" make such distributions."

B. Overdue Distributions/Mandatory Distribution Trusts" - UTC § 506; OUTC § 5805.05

As was done in OUTC § 5805.02(D) (the Ohio provision that corresponds to § 503[c] regarding the attachment of distributions by exception creditors), the OUTC adds express language to § 5805.05 (which corresponds to UTC § 506, dealing with the attachment of mandatory distributions) to permit a court to limit the award to take into account the supplemental needs of SNT beneficiaries.

5805.05 Mandatory distribution trusts.

(A) To the extent that a trust which gives a beneficiary the right to receive one or more mandatory distributions does not contain a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to attach present or future mandatory distributions to or for the benefit of the beneficiary, or to reach the beneficiary's interest by other means. The court may limit an award under this section to such relief as is appropriate under the circumstances, considering among other factors determined appropriate by the court, if any, the support needs of the beneficiary, the beneficiary's spouse, and the beneficiary's dependent children, or, with respect to a beneficiary who is the recipient of public benefits, the supplemental needs of the beneficiary if the trust was not intended to provide for the beneficiary's basic support. If in exercising its power under this section the court decides to order either a sale of a beneficiary's interest or that a lien be placed on the interest, in deciding between the two, the court shall consider (among other factors it deems relevant, if any) the amount of the claim of the creditor or assignee and the proceeds a sale would produce relative to the potential value of the interest to the beneficiary.

(B) Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution the beneficiary is entitled to receive if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date.

III. SPENDTHRIFT PROVISIONS

A. Validity of Spendthrift Provisions - UTC § 502; OUTC § 5805.01

Under § 5805.01(A), a spendthrift provision is not valid unless it restrains both voluntary and involuntary transfers of a beneficiary's interest. The OUTC will likely allow spendthrift protection if the trust permits voluntary transfers only with the consent of the trustee.

5805.01

(A) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest. A spendthrift provision that permits voluntary transfer of a beneficiary's interest only with the consent of a trustee who is not the beneficiary is valid.

B. Spendthrift Exception Creditors

No decisions were found in Ohio in which former spouses with judgments for unpaid alimony were able to enforce those judgments against spendthrift trusts of which their ex's were beneficiaries, so former spouses were dropped from the list of exception creditors in the OUTC. For the same reason, dropped from the Ohio list of exception creditors was "a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust." In the few Ohio cases in which current spouses and children with judgments for support were able to bypass spendthrift provisions, the subject trusts included a support standard. In order to codify these decisions, the Joint Committee made the modifications to UTC § 503 set forth below. Also added was the statement that the court may limit the award to take into account the support needs of the beneficiary, as well as the supplemental needs of the beneficiary of an SNT that was not created for the purpose of providing support. To make it clear that the only creditors for whom the remedy of attachment was available were the enumerated exception creditors, the OUTC counterpart of UTC § 503(c) was reworded as shown in division (D), below. Lastly, because of concerns about the statement contained in *Restatement (Third)* that the list of exception creditors can increase over time with evolving public policy (a statement found nowhere in the UTC or its comments), this section adds a new division (E) to provide that the statutory list of exception creditors is exclusive.

5805.02 Exceptions to spendthrift provision.

(A) As used in this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another state.

(B) Subject to section 5805.03 of the Revised Code, a spendthrift provision is unenforceable against either of the following:

(1) The beneficiary's child or spouse who has a judgment or court order against the beneficiary for support, but only if distributions can be made for the beneficiary's support under the terms of the trust;

(2) A claim of this state or the United States to the extent provided by the Revised Code or federal law.

(C) A spendthrift provision is enforceable against the beneficiary's former spouse.

(D) A claimant described in division (B)(1) or (2) may obtain from the court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances, considering among other factors determined appropriate by the court, if any, the support needs of the beneficiary, the beneficiary's spouse, and the beneficiary's dependent children, or, with respect to a beneficiary who is the recipient of public benefits, the supplemental needs of the beneficiary if the trust was not intended to provide for the beneficiary's basic support.

(E) The only exceptions to the effectiveness of a spendthrift provision are those described in divisions (B) and (D) of this section, in division (B) of section 5805.05 of the Revised Code, and in sections 5805.06 and 5810.04 of the Revised Code.

IV. MODIFICATIONS SPECIFICALLY TARGETED TO SNTS

A. Claims Against Self-Settled SNTs

While the SNT beneficiary is nominally the settlor of (d)(4)(A) trusts, the trust must actually be created by a parent, grandparent, guardian, or by the court. The assets used to fund the trust can be assets of the beneficiary, but in almost all cases the trusts are, instead, funded with assets that the beneficiary was otherwise *about to receive.* Viewed in this light, the common law rule, codified by UTC §505, that permits the settlor's general creditors to reach the trust assets, could be unduly harsh in certain circumstances. For this reason, the OUTC added a new paragraph (3) to division (A) in § 5805.06, to allow the court to limit the award with respect to the OBRA '93 self-settled trusts.

5805.06 Creditor's claim against settlor.

(A) Whether or not the terms of a trust contain a spendthrift provision, all of the following apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(3) With respect to a trust created pursuant to 42 U. S. C. section 1396p(d)(4)(A) or (C), the court may limit the award of a settlor's creditor under division (A)(1) or (2) of this section to such relief as is appropriate under the circumstances, considering among other factors determined appropriate by the court, if any, the supplemental needs of the beneficiary.

B. Methods of Creating Trusts - UTC § 401; OUTC § 5804.01

The methods of creating a trust listed in UTC § 401 do not include court ordered special needs trusts that are authorized by OBRA '93. Following the lead of Missouri, the OUTC will likely add subsection (4) to § 5804.01, as follows:

5804.01. A trust may be created by any of the following methods:

(1) Transfer of property to another person as trustee during the settlor's lifetime or by will or other disposition taking effect upon the settlor's death;

(2) Declaration by the owner of property that the owner holds identifiable property as trustee;

(3) Exercise of a power of appointment in favor of a trustee; or

(4) A court order.

C. Requirements for creation - UTC § 402; OUTC § 5804.02

UTC § 402 includes among the requirements to create a trust that the settlor have capacity and express an intention to create the trust. Because self-settled (d)(4)(A) trusts and (d)(4)(C) pooled fund accounts are funded with assets of the beneficiary, the UTC treats the beneficiary as the settlor. The disabled beneficiary, however, may lack both the capacity to create a trust as well as the ability to indicate an intention to create a trust. For this reason, the OUTC will likely modify the first two requirements accordingly, again following the lead of the Missouri Bar.

5804.02

(A) A trust is created only if all of the following apply:

(1) The settlor, other than a trust created by a court order, has capacity to create a trust;

(2) The settlor, other than a trust created by a court order, indicates an intention to create the trust;

D. Modification or termination of noncharitable irrev trust - UTC § 411; OUTC § 5804.11

Generally, UTC § 411 allows the settlor and all beneficiaries to modify or terminate a trust. Because federal SSI requirement prohibit a beneficiaries of OBRA '93 self-settled SNTs from having the ability to terminate the trust, members of the Missouri Bar expressed concerns that the Social Security Administration as a basis to deny SSI benefits to SNT beneficiaries in UTC states could use this section. To address those concerns that section was made inapplicable to those types of trust.

(A) If upon petition the court finds that the settlor and all beneficiaries consent to the modification or termination of a noncharitable irrevocable trust, the court shall enter an order approving the modification or termination even if the modification or termination is inconsistent with a material purpose of the trust. A settlor's power to consent to a trust's modification or termination may be exercised by an agent under a power of attorney only to the extent expressly authorized by both the power of attorney and the terms of the trust; by the settlor's guardian of the estate with the approval of the court supervising the guardianship if an agent is not so authorized; or by the guardian of the settlor's person with the approval of the court supervising the guardianship if an agent is not so authorized and a guardian of the estate has not been appointed. This division applies only to irrevocable trusts created on or after the effective date of this Code, and to revocable trusts which become irrevocable on or after the effective date of this Code. This division does not apply to a noncharitable irrevocable trust described in 42 U.S.C. § 1396p(d)(4).

E. § 5804.18. Irrevocability of OBRA '93 trusts

In determining, a special needs trust beneficiary's eligibility for SSI, the Social Security Administration looks to state law to determine whether the trust is irrevocable. In a few states, including Ohio, the SSA takes the position that a trust, which by its terms is irrevocable, is treated as being revocable if it fails to name a remainder beneficiary, or if the remainder beneficiaries are the settlor's heirs. Many special needs trusts are created by the court through a guardianship. Because Ohio law

does not allow a guardian to make a will for the ward, Ohio courts have required that OBRA '93 special needs trusts name the ward's "heirs" or the ward's estate as beneficiary of the trust upon the settlor's death following the mandatory Medicaid payback. Using the Doctrine of Worthier Title or the Rule in Shelley's case, the SSA sometimes takes the position that such a trust is revocable, even if its terms state that it is irrevocable. The OUTC will likely include a new §5804.18 to address this situation.

F. § 5804.18 Irrevocability of trusts created under 42 U.S.C. 1396p(d)(4)

A trust described in 42 U.S.C. §1396p(d)(4) is irrevocable if the terms of the trust prohibit the settlor from revoking it, even if the settlor's estate or the settlor's heirs are named as the remainder beneficiary of the trust upon the settlor's death.

V. ADDITIONAL CHANGES THAT COULD AFFECT SNTS

A. Judicial Termination of Trusts on Public Policy Grounds - UTC §410, OUTC §5804.10

UTC § 410 provides that a trust can be terminated if a court determines, among other things, that its purpose has become contrary to public policy. The reference to the possibility that an SNT could terminate upon the finding by any judge of a court of competent jurisdiction that it (or SNTs in general) is against public policy is a matter of concern to many practitioners. In an Ohio case that achieved national notoriety, *Young v. Ohio Dept. of Human Services*[73] an Ohio Supreme Court Justice, Justice Stratton, in dissent, stated that SNTs are against the public policy of the state of Ohio:

> Where a child has reached the age of majority and the obligation to support has ceased, I strongly believe it would be against public policy to allow a parent to create a trust where the trust income or trust corpus can go to the child at the discretion of the trustee, except when such distributions would render the child ineligible for medical assistance from the government.

With a significant number of judges coming down firmly on the side of so-called "personal accountability" and with growing pressures to cut virtually all types of social spending, the Joint Committee felt it best to eliminate the reference to public policy. Our corresponding section to UTC § 410, OUTC § 5804.10, reads as follows:

> 5804.10 Modification or termination of trust; proceedings for approval or disapproval.
>
> (A) In addition to the methods of termination prescribed by sections 5804.11 to 5804.14 of the Revised Code, a trust terminates to the extent the trust is revoked or expires pursuant to its terms, a court determines that no purpose of the trust remains to be achieved, or a court determines that the purposes of the trust have become unlawful or impossible to achieve.

73. 76 Ohio St.3d 547, 668 N.E.2d 908 (1996).

B. Ability to Compel Distributions

Because Ohio case law provides no basis upon which former spouses are able to compel distributions, the Joint Committee added a provision that states that a spouse who received a judgment while still married would not be able to enforce it against the former spouse following the termination of the marriage. In the one Ohio case a child was able to compel a distribution from a spendthrift support trust that had been established for the benefit of the child's father,. The court attached significance to the fact that the grantor had not expressed an intention to preclude the plaintiff (the grantor's grandchild) from being able to benefit from the trust. For this reason, the OUTC allows the grantor to expressly provide that a spouse or child of the beneficiary is not to have the ability to compel distributions. Because there is no judicial precedent in Ohio for the judicial sale of discretionary interests, the OUTC added a new division (E) to prohibit such sales. It should be noted that of Division (C) was added to codify the holding of the Ohio Supreme Court in *Bureau of Support v. Kreitzer*[74], and that the addition of this provision in other states would likely result in a potentially significant expansion of State remedies. The decision was made in Ohio to codify the *Kreitzer* ruling in this manner so that the OUTC would remain revenue neutral to the state of Ohio, and also to prevent the judicial expansion of the *Kreitzer* decision by making it available to other types of creditors or in situations where the trust does include a spendthrift provision.

5805.04 Discretionary trusts that are not wholly discretionary trusts.

(A) As used in this section, "child" includes any person for whom an order or judgment for child support has been entered in this or any other state.

(B) Except as otherwise provided in divisions (C) and (D) of this section, whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if the discretion is expressed in the form of a standard of distribution or the trustee has abused the discretion.

(C) Division (B) of this section does not apply to this state for any claim for support of a beneficiary in a state institution if the terms of the trust do not include a spendthrift provision and do include a standard for distributions to or for the beneficiary under which the trustee may make distributions for the beneficiary's support.

(D) Unless the settlor has explicitly provided in the trust that the beneficiary's child or spouse or both are excluded from benefiting from the trust, to the extent a trustee of a trust that is not a wholly discretionary trust has not complied with a standard of distribution or has abused a discretion, both of the following apply:

(1) A distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support of the beneficiary's child or spouse, provided that the distributions may be ordered only if distributions can be made for the beneficiary's support under the terms of

74. *Supra*, n. 43.

the trust and that no such distributions may be ordered to satisfy a judgment or court order against the beneficiary for alimony;

(2) The court shall direct the trustee to pay to the child or spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

(E) Even if a trust does not contain a spendthrift provision, to the extent a beneficiary's interest in a trust is subject to the exercise of the trustee's discretion (whether or not such discretion is subject to one or more standards of distribution), the interest may not be ordered sold to satisfy or partially satisfy a claim of the beneficiary's creditor or assignee.

C. Rights of Creditors of Settlor of Revocable Trust after Settlor's Death.

UTC § 505(a)(3), consistent with the laws of most states, provides that if the settlor's probate estate is inadequate, creditors of the settlor may reach the trust assets after the settlor's death. Because of a 1939 Ohio Supreme Court decision which held to the contrary, the OUTC removed this provision.

APPENDIX B

GOVERNMENTAL CLAIMS FOR THE REPAYMENT OF MEDICAID BENEFITS

This appendix is a summary of the federal law regarding estate recovery. Note that many states have enacted estate recovery legislation that appears to go beyond the scope of what is authorized by federal law. For an excellent discussion of expanded estate recovery, see the article by Oppenheim and Moschella in 1 NAELA J. 7 (Spring 2005).

Pre-September 3, 1982.

Prior to September 3, 1982, federal law was silent on whether state Medicaid programs could recover payments properly made for qualified beneficiaries. As Medicaid is a governmental benefit paid to eligible individuals, presumably no state recovery rights existed, however there is no law on this point.

TEFRA.

TEFRA, enacted on September 3, 1982, added a new Section 1917 to the Social Security Act, codified as 42 U.S.C. § 1396p, made two significant changes. First, it *permitted* the states to recover an amount equal to Medicaid benefits properly paid on behalf of individuals who were 65 years of age or older when services were provided by recovery against their estates after death. Second, for a "permanently institutionalized" individual, the states were permitted to impose a lien against the Medicaid recipient's real property prior to death "on account of medical assistance paid."

OBRA 1993.

In 1993 federal law was amended to *require* estate recovery, and to lower the age of the recipient against whose estates it could be sought from 65 to 55. The protections for spouses, certain children and siblings, and all cases where hardship might be shown, remained unchanged. States were authorized to place post-death liens (as contrasted with the pre-death liens authorized by TEFRA) on real estate to protect the state's interest in the property of Medicaid recipients. In addition, recovery was to be sought from the estates of permanently institutionalized adults, regardless of age.

To implement the OBRA '93 amendments, CMS added Section 3810 to the State Medicaid Manual, "Medicaid Estate Recoveries," which can be found at http://www.cms.hhs.gov/manuals/45_smm/sm_03_3_3800_to_3812.asp

Pre-Death Liens.

TEFRA liens were, and remain, the only liens that permitted prior to the death of the Medicaid recipient. Pre-death liens may be imposed upon the homes of living Medicaid recipients, regardless of age, who have been determined (after notice and an opportunity for a hearing) to be "permanently institutionalized" and not likely to return

home. If, however, the Medicaid recipient is able to return home, the state must dissolve the liens.

In addition to the restrictions discussed below, states may not place a TEFRA lien on an individual's home if the spouse or the individual's child who is under age 21, blind, or disabled lawfully resides in the home.

Post-Death Liens.

Post-death liens (also known as non-TEFRA liens or estate liens) must follow state law, although federal law dictates certain notice requirements. While estate recovery was made mandatory by OBRA '93, the use of post-death liens is optional, federal law permitting states to file "post-death," or "estate recovery" liens against the real property of persons who are permanently institutionalized and those who received Medicaid services after age 55, whether or not they were received in an institution.

A post-death lien can only be placed on real estate owned by the Medicaid recipient. If the spouse owns the home, a lien cannot be used. While it appears as though states may place a post-death lien on the home during the lifetime of the surviving spouse if the recipient owned the home, the lien cannot be enforced during the lifetime of the spouse. In addition, the Nevada Supreme Court, in *State of Nevada v. Estate of Ullmer*, addressed the enforcement of liens during the lifetime of the community spouse. The Court held that where a lien is imposed following the death of the institutionalized spouse,. but during the lifetime of the surviving spouse, the lien must clearly and unequivocally provide that the state will release it upon the surviving spouse's demand pursuant to any bona fide sale or financial transaction involving the home.

Restrictions Applicable to Both Pre- and Post-Death Liens.

If a lien of either type is placed on an individual's home, adjustment or recovery (i.e. enforcement of the lien) can only be made after the death of the surviving spouse. Additionally, no lien can be enforced if there is a sibling of the individual residing in the home who was also residing in the home for at least one year immediately before the date of the individual's admission to the medical institution. Further, no lien can be enforced if there is a live-in caregiver a son or daughter of the individual (who was residing in the individual's home for a period of at least two years immediately before the date of the individual's admission to the medical institution). The State Medicaid Manual adds an additional requirement that the sibling or caregiver child must have continuously resided in the home since the date of institutionalization.

All States are required to establish procedures and standards for waiving recovery to avoid "undue hardship."

No state may impose either a pre-death or a post-death lien unless it amends its "State Plan" that is mandated by 42 U.S.C. § 1396a(a)(1) and submits the amended plan to CMS for approval. The State Plan amendment, besides stating the state's intention to impose liens, must address the manner in which the state will handle undue hardship waivers and provide for advance notice of any proposed recovery, and specify the hearing and appeal rights and the time frames involved.