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# The Rights of Creditors of Beneficiaries under the Uniform Trust Code: An Examination of the Compromise

Alan Newman, *University of Akron School of Law*



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# **The Rights of Creditors of Beneficiaries under the Uniform Trust Code: An Examination of the Compromise**

Alan Newman<sup>\*</sup>

In the summer of 2000, the National Conference of Commissioners on Uniform State Laws approved and recommended for enactment the Uniform Trust Code (the “U.T.C.,” or the “Code”).<sup>1</sup> Article 5 of the U.T.C. includes provisions addressing, among other things, the rights of creditors of trust beneficiaries to reach trust assets when the trust instrument includes a spendthrift clause or provides for distributions to be made to or for the benefit of the beneficiaries at the trustee’s discretion. According to the U.T.C. Reporter, Professor David English:

Crafting the provisions of Article 5 on spendthrift protection and the rights of a beneficiary’s creditors to reach the trust proved to be the most difficult task in drafting the Act. The area is controversial and conflicting policy directions yield different results. The result was a compromise, responding at least in part to the concerns of the different factions.<sup>2</sup>

The purposes of this Article are (i) to examine the creditor’s rights provisions of the U.T.C. and the Commissioners’ compromise of the competing policies that had to be

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<sup>\*</sup> Associate Professor of Law, the University of Akron School of Law. B. Acct., 1977, The University of Oklahoma; J.D., with Honors, 1980, The University of Oklahoma; Academic Fellow of the American College of Trust and Estate Counsel. I would like to thank the University of Akron School of Law for a summer research grant that helped support this project and gratefully acknowledge the valuable work of my research assistant, Nicole Endejann.

<sup>1</sup> Unif. Trust Code §§ 101-1106 (2000). The U.T.C. is “the first comprehensive national codification of the law of trusts.” *Id.* Prefatory Note.

<sup>2</sup> David M. English, *Is There a Uniform Trust Act in Your Future?*, PROB. & PROP. Jan.-Feb. 2000, at 25, 30 [hereinafter *Uniform Trust Act in Your Future*]. (The title of Professor English’s article derives from the fact that earlier drafts of the U.T.C. were titled the “Uniform Trust Act.”)

resolved in drafting those provisions,<sup>3</sup> and (ii) to propose two modifications to the creditor's rights provisions by states that enact the U.T.C.

## I. Background

Generally, a beneficiary of a trust who does not lack capacity may voluntarily transfer part or all of his or her interest in the trust<sup>4</sup> and his or her creditors may reach it in satisfaction of their claims.<sup>5</sup> Understandably, that result is not to the liking of most trust settlors; rather, their objectives typically include providing resources for the beneficiaries that they may not squander and that their creditors may not reach.<sup>6</sup> Consequently, beginning in the latter part of the nineteenth century, trust settlors began including provisions in trust instruments stating that the beneficiaries' interests were inalienable by them and could not be reached by their creditors.<sup>7</sup> Trusts including such provisions commonly are referred to as "spendthrift trusts."<sup>8</sup> Although the debate over

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<sup>3</sup> For two earlier proposals to compromise the competing policy considerations surrounding spendthrift trusts, see Anne S. Emanuel, *Spendthrift Trusts: It's Time to Codify the Compromise*, 72 NEB. L. REV. 179 (1993) and ERWIN N. GRISWOLD, SPENDTHRIFT TRUSTS § 556 (2d ed. 1947).

<sup>4</sup> RESTATEMENT (THIRD) OF TRUSTS § 51 (Tentative Draft No. 2, 1999).

<sup>5</sup> *Id.* § 56.

<sup>6</sup> In the case characterized by Dean Griswold as "the greatest single factor in the establishment of spendthrift trusts in the United States," GRISWOLD, *supra* note \_\_\_\_\_, at 22, the Supreme Court described a primary goal of a typical settlor: to secure "the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection...." *Nichols v. Eaton*, 91 U.S. 716, 727 (1875).

<sup>7</sup> GRISWOLD, *supra* note \_\_\_\_\_, at 3. Although trusts providing for the inalienability of the beneficiaries' interests are of relatively recent origin, they represent but a modern version of restraints on the alienation of property, which have been the subject of much controversy in the law for centuries. *See id.* at 3-9.

<sup>8</sup> The Restatement defines a spendthrift trust as one "that restrains voluntary and involuntary alienation of all or any of the beneficiaries' interests." RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. a (Tentative Draft No. 2, 1999). For a discussion of the origin of the term "spendthrift trust," see GRISWOLD, *supra* note \_\_\_\_\_, at 32-33.

the validity of such provisions was intense,<sup>9</sup> they are now generally enforceable in almost all jurisdictions.<sup>10</sup> But because the claims of some creditors of trust beneficiaries can be sufficiently compelling to warrant excepting them from the protection afforded by spendthrift clauses,<sup>11</sup> the debate has not ended; rather, its focus has shifted to determining which claims of creditors should be allowed to override the protection generally afforded by a spendthrift clause.<sup>12</sup>

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<sup>9</sup> For summaries of the debate, see RESTATEMENT (THIRD) OF TRUSTS § 58 rep. notes on cmt. a, at 433-49 (Tentative Draft No. 2, 1999); GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, THE LAW OF TRUSTS AND TRUSTEES § 222 (2d ed. rev. 1992); Emanuel, *supra* note \_\_\_\_\_, at 186-94.

<sup>10</sup> In an article published in 1995, Professor Hirsch noted that at that time spendthrift trusts were only invalid in New Hampshire and North Carolina, while in four states - Alaska, Idaho, Utah, and Wyoming - their validity had not been decided. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 3 n.8 (1995). Since Professor Hirsch's article, New Hampshire and Alaska have enacted statutes validating spendthrift trusts, N.H. REV. STAT. ANN. § 564:23 (1999); ALASKA STAT. § 34.40.110(a) (Michie 2000), and in *Nielson v. Thompson*, 982 P.2d 709, 710-11 (Wyo. 1999), the Wyoming Supreme Court suggested that spendthrift provisions were valid in Wyoming. For a summary of the status of the law on spendthrift trusts in each of the states, see BOGERT, BOGERT & HESS, *supra* note \_\_\_\_\_, § 222, at 406 n.59.

Spendthrift provisions are not limited to instruments under which private trusts are created. By statute in most states, such provisions in annuity contracts and in agreements governing periodic distributions by insurance companies to beneficiaries of life insurance policies after the death of an insured are valid. William S. Huff, *Spendthrift Clauses: Legality and Effect on Post-Transfer Estate Planning*, INSTITUTE ON ESTATE PLANNING ¶ 1201 (1984). Similarly, retirement plans governed by the Employment Retirement and Income Security Act must include provisions prohibiting the assignment or alienation of interests under the plan, 29 U.S.C. § 1056(d) (1994 & Supp. 1999), and will not qualify for favorable tax treatment without spendthrift provisions. Treas. Reg. § 1.401(a)-13(b)(1) (2001). Spendthrift protection is not, however, afforded to assets held by a custodian for the benefit of a minor under the Uniform Transfers to Minors Act. UNIF. TRANSFERS TO MINORS ACT § 11 cmt., 8C U.L.A. 1 (2001).

<sup>11</sup> For example, Restatement (Second) of Trusts § 157 provides:

- Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of an enforceable claim against the beneficiary,
- (a) by the wife or child of the beneficiary for support, or by the wife for alimony;
  - (b) for necessary services rendered to the beneficiary or necessary supplies furnished to him;
  - (c) for services rendered and materials furnished which preserve or benefit the interest of the beneficiary;
  - (d) by the United States or a State to satisfy a claim against the beneficiary.

RESTATEMENT (SECOND) OF TRUSTS § 157 (1959).

<sup>12</sup> See *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

Trust settlors also restrict the alienability of beneficiaries' interests in trusts by several means in addition to including spendthrift provisions in trust instruments. Such devices may be employed because of concerns that policy considerations will cause the spendthrift provision not to be effective with respect to the claims of one or more of a beneficiary's creditors.<sup>13</sup> One such device is the inclusion of a provision terminating the beneficiary's interest if the beneficiary attempts to alienate it or becomes bankrupt, or if the beneficiary's creditors attempt to reach it. Although such provisions are valid, even in jurisdictions in which direct restraints on alienation of the beneficiary's interest are not,<sup>14</sup> the obvious shortcoming of that approach is that although it protects the trust assets from the beneficiary's creditors and assignees, it results in the former beneficiary being unable to continue benefiting from the trust. As a result, the settlor may instead include in the instrument a provision stating that if the beneficiary attempts to alienate the interest or becomes bankrupt, or if creditors of the beneficiary attempt to reach it, the beneficiary's right to receive mandatory distributions from the trust terminates, after which the trustee is authorized to make discretionary distributions for the benefit of the beneficiary and other persons, such as members of the beneficiary's family.<sup>15</sup>

Another means by which a settlor may preclude the voluntary or involuntary alienation of a beneficiary's interest is by providing for the beneficiary's interest to be limited to distributions for support or education.<sup>16</sup> In such a trust, "[t]he character of the

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<sup>13</sup> See generally Emanuel, *supra* note \_\_\_\_\_, at 185.

<sup>14</sup> IIA WILLIAM FRANKLIN FRATCHER, SCOTT ON TRUSTS 77-78 (4th ed. 1987).

<sup>15</sup> *Id.* at 80. See also Scott v. Bank One Trust Co. N.A., 577 N.E.2d 1077 (Ohio 1991).

<sup>16</sup> IIA FRATCHER, *supra* note \_\_\_\_\_, at 146-48.

beneficiary's interest is such that no one but the beneficiary himself can enjoy it.”<sup>17</sup>

Consequently, the traditional rule has been that the beneficiary of such a trust has no power to transfer his or her interest, nor may the beneficiary's creditors reach it.<sup>18</sup> As with spendthrift trusts, however, certain creditors of a beneficiary of a support trust have been allowed to reach his or her interest in the trust.<sup>19</sup> A final commonly used method of preventing a beneficiary's interest in a trust from being voluntarily or involuntarily alienated is to provide for distributions to be made to or for the benefit of the beneficiary only at the trustee's discretion.<sup>20</sup> In such a case, “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.”<sup>21</sup>

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<sup>17</sup> *Id.* at 148. Of course, this approach to protecting a beneficiary's interest in a trust may not suit a settlor who does not want to limit the benefits the trustee may provide the beneficiary to distributions for support and education.

<sup>18</sup> RESTATEMENT (SECOND) OF TRUSTS § 154 (1959). For a discussion of the alienability under the U.T.C. of a beneficiary's interest in a support trust that does not include a spendthrift provision, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>19</sup> *Supra* note \_\_\_\_\_.

<sup>20</sup> The primary purpose for making a beneficiary's interest in a trust discretionary, of course, may not be to prevent its alienation. Rather, the settlor may not want the beneficiary to be entitled to receive mandatory distributions of income or principal from the trust, and may not want distributions to or for the benefit of the beneficiary to be limited by a narrow standard, such as to provide only for the beneficiary's health or education. For a discussion of the elimination of the traditional distinction between support trusts and discretionary trusts by the U.T.C. and the Third Restatement, see *infra* note \_\_\_\_\_ and accompanying text.

<sup>21</sup> RESTATEMENT (SECOND) OF TRUSTS § 155 cmt. b (1959). Note, however, that a beneficiary of a discretionary trust that does not include a spendthrift clause may not be able to receive distributions from the trust after having transferred his or her interest, or after a creditor has served the trustee with process of a proceeding to reach it. *Id.* § 155. In such a case, unless the settlor has validly prohibited the alienation of the beneficiary's interest by including a spendthrift provision in the instrument, a trustee may be personally liable to the beneficiary's transferee or creditor for distributions made to or for the beneficiary's benefit. *Id.*

Note also that under the Third Restatement, a beneficiary of a discretionary trust may be able to compel distributions by the trustee. RESTATEMENT (THIRD) OF TRUSTS § 60, cmt. e, at 488 (Tentative Draft No. 2, 1999). In addition, as discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text, under the U.T.C., in limited circumstances the creditor of a beneficiary of a discretionary trust may be able to compel distributions that it may reach in satisfaction of its claim.

Special rules have been applied when the settlor is a beneficiary of the trust.<sup>22</sup> First, a spendthrift clause will not prevent the settlor from voluntarily transferring his or her interest.<sup>23</sup> Second, if the trust is for the settlor's support, or if the trustee otherwise may make discretionary distributions to or for the benefit of the settlor, the settlor's transferee or creditors can reach the maximum amount that the trustee could pay to or for the benefit of the settlor.<sup>24</sup>

## **II. Overview of Creditors' and Transferees' Rights Under the U.T.C.**

The U.T.C. addresses the rights of creditors and transferees of a beneficiary of a trust to reach the beneficiary's interest in the trust<sup>25</sup> when its governing instrument includes or does not include a spendthrift clause;<sup>26</sup> when the trust instrument provides for distributions to be made to or for the benefit of the beneficiary at the trustee's discretion (regardless of whether standards are provided to guide the trustee's exercise of its discretion);<sup>27</sup> and when the debtor/beneficiary is a settlor of the trust.<sup>28</sup> These provisions of the U.T.C. may be summarized as follows:

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<sup>22</sup> For a discussion of recent legislative changes to the traditional rules in several states, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>23</sup> RESTATEMENT (SECOND) OF TRUSTS § 156(1) cmt. g (1959).

<sup>24</sup> *Id.* § 156(2).

<sup>25</sup> Under the U.T.C., reaching a beneficiary's "interest in the trust" means that the creditor may attach "present or future distributions to or for the benefit of the beneficiary." U.T.C. § 501.

<sup>26</sup> U.T.C. §§ 501-503.

<sup>27</sup> *Id.* § 504.

<sup>28</sup> *Id.* § 505.

1. If the instrument does not include a spendthrift provision, generally, the beneficiary may voluntarily assign his or her interest, and the beneficiary's creditors may reach it.<sup>29</sup>
2. If the instrument includes a spendthrift provision, the beneficiary may not voluntarily transfer his or her interest in the trust.<sup>30</sup>
3. Further, except with respect to the claims of certain classes of creditors, the inclusion of a spendthrift provision prevents creditors of the beneficiary from reaching the beneficiary's interest in the trust.<sup>31</sup>
4. Creditors of the beneficiary who may reach the beneficiary's interest in the trust despite the presence of a spendthrift provision are (a) a beneficiary's child, spouse, or former spouse, who has a judgment for support, and (b) a judgment creditor who has provided services for the protection of the beneficiary's interest in the trust.<sup>32</sup>
5. If distributions may be made to or for the benefit of a beneficiary at the trustee's discretion (including pursuant to a standard, such as providing for the beneficiary's support) then regardless of whether the instrument includes a spendthrift provision, the only creditor of the beneficiary who may compel a distribution that the creditor may reach is a child, spouse, or former spouse of the beneficiary who has a judgment or court order for

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<sup>29</sup> *Id.* § 501; *see infra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>30</sup> *Id.* § 502(c).

<sup>31</sup> *Id.* § 502(c); *see infra* notes \_\_\_\_ - \_\_\_\_ and accompanying text. Note, however, that under the U.T.C., any creditor of the beneficiary may reach distributions the trustee is required to make to the beneficiary but does not distribute within a reasonable time, even if the instrument includes a spendthrift provision. *Id.* § 506; *see infra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>32</sup> *Id.* § 503(a), (b). Further, claims of the state or the United States will not be barred by a spendthrift clause to the extent a federal or state statute so provides. *Id.* § 503(c).



support and who can show that the trustee has abused its discretion or not complied with a standard of distribution.<sup>33</sup>

6. The creditors of the settlor of a trust that is revocable by the settlor may reach the trust assets during the settlor's lifetime or after the settlor's death.<sup>34</sup>
7. If the settlor is a beneficiary of the trust, but may not revoke it, the settlor's creditors or assignees may reach the maximum amount the trustee may distribute to or for the benefit of the settlor.<sup>35</sup>

### III. U.T.C. Section 501: In the Absence of Spendthrift Protection

The first of the U.T.C.'s creditor's rights provisions sets forth the rules applicable when a spendthrift provision either is not included in the trust instrument,<sup>36</sup> is not effective with respect to a particular creditor's claim, or applies to part but not all of the beneficiary's interest in the trust:

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<sup>33</sup> *Id.* § 504; *see infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>34</sup> *Id.* § 505(a)(1), (3); *see infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>35</sup> *Id.* § 505(a)(2); *see infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>36</sup> Although it is difficult to estimate with any certainty how common spendthrift provisions are, it is generally believed that most trust instruments include them. *See, e.g.*, BOGERT, BOGERT & HESS, *supra* note \_\_\_\_\_, § 222, at 389-90; Hirsch, *supra* note \_\_\_\_\_ and authorities cited therein. A relatively early discussion of the use of spendthrift provisions in estate planning suggested that they were "frequently thrown into trust drafting almost as 'boiler plate.' When it is proposed, most clients think it an excellent idea. They don't want to see their fund dissipated, and they like the idea of blocking creditors." Rene A. Wormser, *Spendthrift Trusts as Part of an Estate Plan*, INSTITUTE ON ESTATE PLANNING ¶ 71.900 (1971). A disadvantage of using spendthrift provisions, however, is that they reduce the beneficiaries' flexibility in dealing with their interests in trusts. *See* JOHN R. PRICE, PRICE ON CONTEMPORARY ESTATE PLANNING

**SECTION 501. RIGHTS OF BENEFICIARY’S CREDITOR OR ASSIGNEE.** To the extent a beneficiary’s interest is not protected by 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.<sup>37</sup>

Most fundamentally, section 501 affirms the traditional rules that a beneficiary of a trust generally may assign his or her interest in the trust and his or her creditors may reach it.<sup>38</sup> Although the U.T.C. does not include procedures for a creditor to follow to attach a beneficiary’s interest in a trust,<sup>39</sup> it contemplates that the creditor “will serve an order on the trustee attaching the beneficiary’s interest.”<sup>40</sup> Thereafter, “[a]ssuming the validity of the order cannot be contested, the trustee will then pay to the creditor instead of to the beneficiary any payments the trustee would otherwise be required to make to the beneficiary.... The creditor may also, in theory, force a judicial sale of a beneficiary’s interest.”<sup>41</sup>

Such a result, however, obtains only “[t]o the extent a beneficiary’s interest is not protected by a spendthrift provision . . .”<sup>42</sup> With respect to the question of what constitutes a protection affording “spendthrift provision,” the U.T.C. defines the phrase as “a term of a trust which restrains both voluntary and involuntary transfer of a

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896-97 (1992); KATHRYN G. HENKEL, ESTATE PLANNING AND WEALTH PRESERVATION ¶ 4.02[2][d] (1997); Howard M. Zaritsky, *A QPRT Checklist*, PROB. PRAC. REP., May 2000, at 1, 3-4.

<sup>37</sup> U.T.C. § 501.

<sup>38</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>39</sup> U.T.C. § 501 cmt.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> U.T.C. § 501.

beneficiary's interest."<sup>43</sup> Thus, unless such a clause restrains voluntary as well as involuntary transfers, it will not be valid.<sup>44</sup> Although the U.T.C. does not require any particular language to create a spendthrift trust,<sup>45</sup> no guidance is given on the question of whether language expressly prohibiting either voluntary or involuntary transfers, but not both, will be deemed to prohibit both when the trust instrument does not specifically allow the other kind of transfer.<sup>46</sup> It is clear, however, that spendthrift protection will not be afforded under the U.T.C. unless the settlor's intention to create such a trust is manifest in the trust's terms.<sup>47</sup>

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<sup>43</sup> U.T.C. § 103(15).

<sup>44</sup> U.T.C. § 502(a). According to the U.T.C. Reporter, Professor English, "[t]he drafting committee concluded that it was undesirable as a matter of policy for a beneficiary to be able to transfer the beneficiary's interest while at the same time denying the beneficiary's creditors the right to reach the trust to satisfy their claims." English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 30. See also IIA FRATCHER, *supra* note \_\_\_\_\_, at 113.

<sup>45</sup> In fact, under the U.T.C.: "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." U.T.C. § 502(b). See also RESTATEMENT (SECOND) OF TRUSTS § 152 cmt. c (1959).

<sup>46</sup> Under the Second Restatement, language restraining either voluntary or involuntary transfers may manifest an intention to restrain the other. RESTATEMENT (SECOND) OF TRUSTS § 152 cmts. d, e (1959). The Third Restatement goes further: "language in a trust instrument that only expresses the settlor's intention to restrain voluntary alienation is sufficient to create a spendthrift trust with involuntary alienation restrained as well. When the instrument merely states an intention to restrain involuntary alienation, an intention to restrain voluntary alienation is presumed." RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. b (Tentative Draft No. 2, 1999).

<sup>47</sup> See U.T.C. §§ 501, 502(a), and 502(b). See also RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. b (Tentative Draft No. 2, 1999) ("The settlor must manifest the intention to create a spendthrift trust. 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." (internal reference omitted)); English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 30. By contrast, by statute in some states trusts are spendthrift, even if the instrument does not include a spendthrift provision, unless the transfer of beneficial interests is expressly authorized. See, e.g., N.Y. EST. POWERS & TRUSTS LAW § 7-1.5(a)(1) (McKinney 1992). Further, a few courts in other states have implied a restraint on alienation with little or no express language in the instrument indicating such intent. IIA FRATCHER, *supra* note \_\_\_\_\_, at 119-20; Huff, *supra* note \_\_\_\_\_, at ¶ 1202.4. For example, in *Morrison v. Doyle*, 582 N.W.2d 237 (Minn. 1998), a beneficiary's judgment creditors were prohibited from reaching the beneficiary's trust interest even though the instrument did not include a spendthrift provision. *Id.* at 238. The beneficiary was serving as the trustee, and as such, the beneficiary was to "pay the income and such amounts of the principal as the Trustee in its discretion may determine for the beneficiary's education, support, health, and maintenance." *Id.* at 239. According to the court, that language was sufficient to create a spendthrift trust. *Id.* at 241.

It is equally clear that the U.T.C. contemplates the possibility of part, but not all, of a beneficiary's interest in a trust being protected by a spendthrift clause, because section 501 provides that a creditor or assignee of the beneficiary may reach the beneficiary's interest "to the extent . . . [it] is not protected by a spendthrift provision."<sup>48</sup> Historically, a beneficiary's interest in the principal of the trust could not be made inalienable, even in jurisdictions in which such a restraint could be imposed on the beneficiary's income interest.<sup>49</sup> Today, however, in most jurisdictions a restraint on the transfer of a beneficiary's right to receive principal in the future is valid.<sup>50</sup> But if the settlor restrains transfers of the beneficiary's interest in the trust's income, but not in its principal, spendthrift protection would be afforded only for the income interest.<sup>51</sup>

U.T.C. section 501 does not limit the access of a beneficiary's assignee or creditor to any particular kinds of beneficial interests. Thus, for example, if the trust instrument does not include a spendthrift provision and distributions of income or principal, or both, may be made to or for the benefit of the beneficiary only for the

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<sup>48</sup> U.T.C. § 501. The comment to section 501 does not address the partial protection issue, but simply states that "[a]bsent a valid spendthrift provision, a creditor may reach the interest of a beneficiary the same as any other of the beneficiary's assets." U.T.C. § 501 cmt.

<sup>49</sup> IIA FRATCHER, *supra* note \_\_\_\_, at 132. It has been suggested that this difference in treatment was designed "to limit the developing acceptance of spendthrift trusts." RESTATEMENT (THIRD) OF TRUSTS § 58 rep. notes on cmt. a, at 449 (Tentative Draft No. 2, 1999). A more specific rationale for denying spendthrift protection to interests in principal while granting it to interests in income rests on the argument:

that there is more public detriment in a restraint on the right to principal than in the case of income, that one reason for sanctioning spendthrift trusts is to insure that the beneficiaries have funds for living expenses, and that a clause as to principal usually does not serve such a purpose but rather has the object of conserving the estate for those selected by the settlor.

BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 222, at 390.

<sup>50</sup> IIA FRATCHER, *supra* note \_\_\_\_, at 138; RESTATEMENT (THIRD) OF TRUSTS § 58 rep. notes on cmt. a, at 449-50 (Tentative Draft No. 2, 1999). In some states statutes governing the validity of spendthrift provisions expressly afford or deny protection to interests in principal. BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 222, at 392-93.

beneficiary's support, the interest may be voluntarily or involuntarily alienated.<sup>52</sup> As a result, a creditor of a beneficiary of such a trust may be able to attach part or all of present and future distributions that otherwise would be made to or for the benefit of the beneficiary for his or her support.<sup>53</sup> By contrast, under the Restatement (Second) of Trusts, a beneficiary's interest in a support trust may not be transferred and the beneficiary's creditors may not reach it.<sup>54</sup> This difference in treatment, however, may not be as substantive as it at first appears. While section 501 permits a beneficiary's creditor to reach any interest of the beneficiary in a trust, including one limited to receiving distributions for the beneficiary's support, it also provides that the court authorizing the creditor to do so "may limit the award to such relief as is appropriate under the circumstances."<sup>55</sup> Thus, if the beneficiary can demonstrate to the court a need for support distributions from the trust, the court may limit or prohibit the creditor from reaching those distributions.<sup>56</sup>

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<sup>51</sup> See IIA FRATCHER, *supra* note \_\_\_\_\_, at 136-37 and cases discussed therein.

<sup>52</sup> But for a discussion of the court's equitable power to limit the ability of a creditor to reach a beneficiary's interest in a trust under the U.T.C., see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>53</sup> The comment to section 501 states that it does not prescribe the procedure by which a creditor could do so – "leaving that issue to the enacting State's laws on creditor rights" – but contemplates that after a valid court order of attachment is issued, the trustee would "pay to the creditor instead of to the beneficiary any payments the trustee would otherwise be required to make to the beneficiary, as well as discretionary distributions the trustee decides to make." U.T.C. § 501 cmt. Note that with the exception of a child or spousal support claimant, the U.T.C. does not allow the beneficiary's creditor to compel discretionary payments, regardless of whether the trustee failed to comply with a standard of distribution or abused a discretion. U.T.C. § 504; see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>54</sup> RESTATEMENT (SECOND) OF TRUSTS § 154 (1959).

<sup>55</sup> U.T.C. § 501.

<sup>56</sup> U.T.C. section 501 allows the court to limit a creditor's access to a beneficiary/debtor's interest in a trust as the court determines "is appropriate under the circumstances." *Id.* The court's equitable power to do so under section 501 is not limited to considerations of the needs of the beneficiary, or of the beneficiary and his or her family. Note, however, that the comment to section 501 cites a comment to a provision of the Third Restatement as support for the court being given discretion to limit the award. *Id.* § 501 cmt. The cited comment from the Third Restatement states that a court "may order less than all of the payments [that the trustee otherwise would pay to the beneficiary] to be made to the creditor, leaving some distributions for the actual needs of the beneficiary and his or her family." RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. e, at 397 (Tentative Draft No. 2, 1999). Further, according to the American Bar Association Section of Real Property, Probate and Trust Law Advisor to the Drafting Committee of the

The court's equitable power to limit a creditor's award also may be useful in other circumstances. For example, while a creditor's remedies under section 501 may extend to forcing a sale of the beneficiary's interest in the trust,<sup>57</sup> the court may exercise its discretion to prohibit such a sale.<sup>58</sup> Further, unlike the Third Restatement,<sup>59</sup> the U.T.C. does not require that a beneficiary's creditor attempt to satisfy its claim from property of the debtor other than his or her interest in the trust before proceeding to reach the trust.<sup>60</sup> Although the rationale for requiring a creditor to proceed against legal interests of the debtor before attempting to reach equitable ones may be largely a matter

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Uniform Trust Code, "[i]n any creditor attachment, equitable principles will apply. The court will be able to consider the beneficiary's needs in order to assure a minimum standard of maintenance for the beneficiary and the beneficiary's dependents." Raymond H. Young, *New Uniform Trust Code Modernizes and Clarifies Rules Governing Trusts*, 27 EST. PLAN. 108, 110 (2000). *See also id.* Reporter's Memorandum to Members of the Institute, at xxx (describing the court's discretion to limit a creditor's award as allowing the court "to protect a subsistence amount from an indebted beneficiary's attaching creditors").

<sup>57</sup> U.T.C. § 501 cmt. ("The creditor may also, in theory, force a judicial sale of a beneficiary's interest."). The Third Restatement suggests that such a sale "may be appropriate when it appears unlikely that the debt can be satisfied from distribution(s) within a reasonable time, particularly when the beneficiary's interest is a future interest." RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. e, at 397 (Tentative Draft No. 2, 1999).

<sup>58</sup> The Third Restatement provides:

[T]he uncertainty or remoteness of the interest may be such that its forced sale would produce little relative to its value to the beneficiary, and perhaps also too little to satisfy the creditor's claim. In that case, unless a loan or other arrangement can be obtained, it would be appropriate for the court to grant the creditor a lien on the beneficiary's interest, to be realized if and when it falls into possession.

RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. e, at 397 (Tentative Draft No. 2, 1999).

<sup>59</sup> "[A] creditor can subject the beneficiary's interest to the satisfaction of a claim under the rule of this section after having attempted to satisfy the claim out of legal interests of the beneficiary, or when it appears that an attempt to do so would be unsuccessful." *Id.* § 56 cmt. e, at 396.

<sup>60</sup> Section 501 includes no such limitation. Rather, the comment to section 501 provides simply that "the interest of a beneficiary [in a trust may be reached] the same as any other of the beneficiary's assets." U.T.C. § 501 cmt.

of history,<sup>61</sup> doing so may avoid problems that otherwise would be created between the creditor, the other beneficiaries of the trust, and the trustee.<sup>62</sup>

An interesting question not directly addressed by the U.T.C. is whether a creditor of a beneficiary, who is not the settlor, of a revocable trust that does not include a spendthrift provision may reach the beneficiary's interest during the settlor's lifetime. Because "the property of such a trust is ordinarily treated as though it were owned by the settlor,"<sup>63</sup> under the Restatement, such a creditor may not do so:

[B]eneficiaries of a revocable trust [other than the settlor] are treated . . . as if they had no existing property interests (that is, their rights are treated like the bare expectancies of will beneficiaries) so long as the power to revoke exists. Accordingly, these revocable interests are not reachable by the creditors of those beneficiaries.<sup>64</sup>

The U.T.C. includes no such exception to the general rule of section 501 authorizing a court to allow a creditor of any beneficiary of a non-spendthrift trust to reach the beneficiary's interest.<sup>65</sup>

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<sup>61</sup> See IIA FRATCHER, *supra* note \_\_\_\_\_, at 61-62 (discussing the requirement that a claimant pursue remedies at law before seeking equitable relief).

<sup>62</sup> For example, if the debtor/beneficiary is entitled to receive distributions of income from the trust for life, with the principal to be paid to his or her descendants, allowing the debtor's creditor to reach the income interest in the trust could result in a circumstance in which (i) the creditor attempts to force the trustee to manage the trust assets in such a way as to maximize income, at the expense of the growth of principal; (ii) the descendants attempt to force the creditor to invest for the growth of principal at the expense of income; and (iii) the trustee attempts to invest to satisfy the interests of both. See RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 cmt. e, i (1992).

<sup>63</sup> RESTATEMENT (THIRD) OF TRUSTS § 25(2) (Tentative Draft No. 2, 1999).

<sup>64</sup> *Id.* § 56 cmt. b, at 394.

<sup>65</sup> U.T.C. § 501. The closest the U.T.C. comes to treating the assets of a revocable trust as being owned by the settlor and ignoring the interests of other beneficiaries is found in section 603, which provides that:

(a) While a trust is revocable and the settlor has capacity to revoke the trust, rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor; and

#### IV. U.T.C. Sections 502 and 503: Spendthrift Protection

U.T.C. sections 502 and 503 address the validity of spendthrift provisions and exceptions to the protection they provide against the claims of creditors of trust beneficiaries. In considering them, it is important to recognize that the nature of a beneficiary's interest in the trust may provide an additional obstacle to his or her creditors.<sup>66</sup> To illustrate, if the beneficiary's only interest in a trust that includes a spendthrift provision is that the trustee is authorized, in its discretion, to make distributions of income, principal, or both to or for the benefit of the beneficiary, a creditor of the beneficiary may be prevented from reaching the beneficiary's interest by the spendthrift provision.<sup>67</sup> But if the instrument does not include one, the creditor

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(b) While a trust is revocable and the settlor does not have capacity to revoke the trust, rights of the beneficiaries are held by the beneficiaries.

U.T.C. § 603.

Although the settlor could, of course, amend the trust instrument to revoke the beneficiary's interest if a creditor attempted to attach it, if the settlor were incapacitated such an amendment could be accomplished by a conservator or guardian of the settlor only with the approval of the court supervising the conservatorship or guardianship, U.T.C. § 602(f), or by an agent under a power of attorney only if expressly authorized by the power or by the trust instrument. U.T.C. § 602(e). For a case in which a revocable trust beneficiary's interest was reachable in his bankruptcy proceeding when the settlor, his mother, died a month after the bankruptcy petition was filed, see *In re Crandall*, 173 B.R. 836 (Bankr. D. Conn. 1994); contra *Schmitt v. Ulrich*, 215 B.R. 417 (B.A.P. 9th Cir. 1997). For a case treating a married child's future interest in his living parent's revocable trust as an asset subject to division in the child's divorce proceeding, see *In re Gorman*, 36 P.3d 211 (Colo. App. 2001).

<sup>66</sup> U.T.C. § 504; see David M. English, *Drafting the Uniform Trust Act*, A.L.I.-A.B.A. Course of Study, June 24, 1999, available at WL SD84 ALI-ABA 115, 129 [hereinafter *Drafting the Act*].

<sup>67</sup> To say that a spendthrift provision prevents the beneficiary's creditor from reaching the beneficiary's interest in the trust is to say (i) that the beneficiary's creditor cannot attach the interest itself, and (ii) that amounts of income or principal that are distributable to the beneficiary – as mandatory distributions or as a result of the exercise of the trustee's discretion – may not be reached while properly held by the trustee. RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. d, at 425 (Tentative Draft No. 2, 1999). Spendthrift protection, however, does not extend to trust distributions the beneficiary has received: “After the income or principal of a spendthrift trust has been distributed to a beneficiary . . . it can be reached by creditors through the same procedures and in accordance with the same rules that apply generally to property of the



nevertheless may not be able to reach the assets in the trust unless and until the trustee exercises its discretion to make distributions to or for the benefit of the beneficiary.<sup>68</sup>

Because this section of this Article examines the effect of a spendthrift provision on the ability of creditors of a beneficiary to reach the beneficiary's interest in the trust, it assumes a trust as to which the beneficiary's rights to receive distributions of income, principal, or both are not subject to the trustee's discretion.<sup>69</sup>

For example, assume that Settlor includes a spendthrift provision<sup>70</sup> in an instrument that provides that the income earned by the trust's assets is to be distributed to Spouse annually until Spouse's death, at which time the principal is to be distributed to Child.<sup>71</sup> If Spouse purports to assign his or her interest in the trust to Spouse's Transferee, must the trustee make distributions of the income the trust earns during the rest of Spouse's life to Spouse's Transferee? Similarly, if Child purports to assign his or

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beneficiary." *Id.* But see *Burns v. Miller, Hiersche, Martens & Hayward, P.C.*, 948 S.W.2d 317 (Tex. App. 1997).

<sup>68</sup> See *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>69</sup> Under the U.T.C., a beneficiary's right to receive distributions from a trust is treated as subject to the trustee's discretion even if the settlor provides for distributions to be made to or for the benefit of the beneficiary for stated purposes, such as the beneficiary's support. U.T.C. § 504; see *infra* note \_\_\_\_\_ and accompanying text.

<sup>70</sup> For example:

No principal or income payable or to become payable under any of the trusts created by this instrument shall be subject to anticipation or assignment by any beneficiary thereof, or to the interference or control of any creditors of such beneficiary or to be taken or reached by any legal or equitable process in satisfaction of any debt or liability of such beneficiary prior to its receipt by the beneficiary.

See *Scheffel v. Krueger*, 2001 WL 839850 (N.H. July 26, 2001). For several other examples of spendthrift provisions, see Huff, *supra* note \_\_\_\_\_, ¶ 1202.5.

<sup>71</sup> Trusts that dictate that trust income and principal be distributed to different beneficiaries present difficult issues with respect to the characterization of trust receipts and disbursements as income or principal, and the appropriateness of investment decisions made by the trustee that are intended to produce varying amounts of income and growth of principal. For a discussion of such issues, and the "total return" or "give-me-five" unitrust solution to some of the problems they present, see Jerold I. Horn, *Prudent Investor Rule, Modern Portfolio Theory, and Private Trusts: Drafting and Administration Including the*

her interest in the trust to Child's Transferee, must the trustee distribute the trust principal to Child's Transferee when Spouse dies? Alternatively, may a creditor of Spouse attach his or her interest in the trust so that the trustee must distribute the trust's income during Spouse's life to the creditor until its claim is satisfied? Similarly, may Child's creditor attach Child's interest in the trust so that the trustee must distribute the trust principal to Child's creditor at Spouse's death? Or may a creditor of Spouse or Child force the sale of his or her interest in the trust so that the trustee must make distributions of income or principal otherwise due to Spouse or Child to forced sale purchasers of their interests? Similarly, if the instrument provides for distributions to be made to Spouse and Child at the trustee's discretion, may a transferee or creditor of the beneficiary force the trustee to pay to the transferee or creditor part or all of distributions the trustee, in the exercise of its discretion, otherwise would make to the beneficiary? These are the kinds of questions that turn on whether a trust instrument includes a valid spendthrift provision and, if so, the extent to which it will be given effect.

In answering such questions for a trust that includes a spendthrift provision, courts and legislatures have – at least theoretically – four alternatives from which to choose. First, the spendthrift provision could be held invalid, in which case the transfers by Spouse and Child would be effective and their creditors would be able to reach their interests.<sup>72</sup> Second, the spendthrift provision could be held valid, without limitation,<sup>73</sup> in

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*"Give-Me-Five" Unitrust*, 33 REAL PROP. PROB. & TRUST J. 1 (1998) and Robert B. Wolf, *Defeating the Duty to Disappoint Equally – The Total Return Trust*, 32 REAL PROP. PROB. & TRUST J. 45 (1997).

<sup>72</sup> See, e.g., N.C. GEN. STAT. § 36A-115 (Supp. 2000).

<sup>73</sup> In no state, however, are spendthrift provisions held effective without any limitation. For example, in all but a handful of states a spendthrift provision will not protect the interest of a settlor/beneficiary. See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. Similarly, under the Restatements a spendthrift

which case the attempted transfers and attachments would be ineffective. Third, the spendthrift provision could be held valid with respect to an attempted voluntary transfer by Spouse or Child, but its validity with respect to creditors' claims could depend<sup>74</sup> on the nature of their claims.<sup>75</sup> Finally, the spendthrift provision could be held valid, but only to a limited extent, such as, for example, to protect only as much income and principal as necessary to provide for the support of the beneficiary.<sup>76</sup>

The first alternative – simply invalidating spendthrift provisions – presumably was not seriously considered by the U.T.C. drafters because of the almost universal acceptance of the general validity of such provisions.<sup>77</sup> The alternative of enforcing

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provision will not protect a non-settlor/beneficiary's interest from claims for child support or alimony. *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. Although Alaska may come closest to allowing a spendthrift provision to provide unlimited protection to a beneficiary's trust interest, even its statute allows creditors to reach beneficiaries' interests in limited circumstances:

- b) . . . [A] transfer restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or another person from satisfying a claim out of the beneficiary's interest in the trust, unless the
  - (1) transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons . . . ;
  - (2) trust provides that the settlor may revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust; . . .
  - (3) trust requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor; or
  - (4) at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order.

ALASKA STAT. § 34.40.110(b) (Michie 2000).

<sup>74</sup> The policy objections to spendthrift trusts are not as strong with respect to prohibitions of voluntary transfers by the beneficiary as they are with respect to preventing a creditor from reaching the beneficiary's interest. *See* IIA FRATCHER, *supra* note \_\_\_\_\_, at 111-13.

<sup>75</sup> By statute or case law in most states, for example, support claims of a spouse or child may be enforced against a beneficiary's interest in a spendthrift trust. RESTATEMENT (THIRD) OF TRUSTS § 59 rep. notes on clause (a) & cmt. b, at 479 (Tentative Draft No. 2, 1999).

<sup>76</sup> For a discussion of statutes so limiting the effect of spendthrift provisions in a number of states, see IIA FRATCHER, *supra* note \_\_\_\_\_, at 98-100.

<sup>77</sup> In two discussions of the drafting of the U.T.C.'s spendthrift provisions, Professor English, the U.T.C. Reporter, made no mention of the possibility of simply holding such provisions invalid. *See* English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 30-31; English, *Drafting the Act*, *supra* note

spendthrift provisions, but to a limited extent designed to protect the trust assets as a means of support for the beneficiaries while also allowing creditors of beneficiaries some access to their trust interests, is not as easily dismissed. Such an approach constitutes a straightforward compromise between a fundamental argument of supporters of spendthrift trusts -- that a property owner should be free to dispose of his or her property with such restrictions as he or she sees fit to impose<sup>78</sup> -- and a fundamental argument of those who oppose them -- that as a matter of policy, a trust beneficiary should not be allowed to enjoy a beneficial interest in property while not paying his or her creditors.<sup>79</sup> Although some courts have analyzed the validity of spendthrift provisions in the context of the inherent property rights of the settlor or

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\_\_\_\_\_, at 29-32. Presumably that alternative was not seriously considered because the general validity of such provisions has been well established for a century or so. Perhaps the most outspoken critic of spendthrift trusts was Professor John C. Gray, who included an attack on them in his 1883 work, *John Chipman Gray, RESTRAINTS ON THE ALIENATION OF PROPERTY* (2d ed. 1895). In his treatise on spendthrift trusts, Dean Griswold introduces his discussion of Professor Gray's attack on such trusts by noting that: "The arguments which he [Professor Gray] set forth have never been completely answered, but, as so frequently happens with such arguments, they have had little influence in shaping the law." GRISWOLD, *supra* note \_\_\_\_\_, at 30. Rather, during the twelve years (1883-1895) between the first and second editions of Professor Gray's work, Dean Griswold noted that "a very considerable number of cases had been decided. Almost without exception, however, they had upheld the validity of spendthrift trusts." *Id.* Some fifty years after Dean Griswold's treatise, reservations about the wisdom of upholding spendthrift trusts remain, as does the recognition that for those opposed to them, the battle has been fought and lost:

Logic, to my mind, impels the conclusion that spendthrift provisions are invalid. Gray's arguments carry the day. Experience, on the other hand, teaches that they are valid. The current of history has swept away Gray's position without refuting it. Spendthrift provisions may be theoretically suspect; they are, nonetheless, not only valid but also thriving.

Emanuel, *supra* note \_\_\_\_\_, at 209. As discussed in note \_\_\_\_\_, *supra*, today, North Carolina may be the only jurisdiction in which spendthrift provisions are invalid.

<sup>78</sup> See, e.g., *Scott v. Bank One Trust Co., N.A.*, 577 N.E.2d 1077, 1083 (Ohio 1991) ("as a matter of policy, it is desirable for property owners to have, within reasonable bounds, the freedom to do as they choose with their own property. That freedom is not absolute . . . . But . . . in a society that values freedom as greatly as ours, this consideration is far from trivial.").

<sup>79</sup> See, e.g., *Utley v. Graves*, 258 F. Supp. 959, 960 (D.D.C. 1966), *rev'd sub nom.* *Am. Sec. & Trust Co. v. Utley*, 382 F.2d 451 (D.C. Cir. 1967) ("[T]here are many who consider it contrary to their notions of right and wrong that a person should be permitted to live on income that he does not earn and yet that is not subject to the claims of his creditors.").

beneficiary of the trust,<sup>80</sup> Dean Griswold's contrary view that the validity of such trusts is simply a matter of policy<sup>81</sup> has prevailed.<sup>82</sup> And as a matter of policy, a number of states by statute have legislated a compromise by limiting the extent to which a spendthrift provision will bar ordinary creditors'<sup>83</sup> claims,<sup>84</sup> an approach supported by many who have examined the spendthrift issue.<sup>85</sup>

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<sup>80</sup> *Compare* *Broadway Nat'l Bank v. Adams*, 133 Mass. 170 (1882) ("The power of alienating in advance is not a necessary attribute or incident of such an estate or interest, so that the restraint of such alienation would introduce repugnant or inconsistent elements.") *with* *Brahmey v. Rollins*, 179 A. 186, 191 (N.H. 1935) (The right of an income beneficiary to receive the trust income "is absolute. It is directly and definitely enforceable. It has been given the beneficiary and is his property as fully and completely and in all respects as much as anything he owns in fee simple.").

<sup>81</sup> GRISWOLD, *supra* note \_\_\_\_\_, § 554. Dean Griswold cautions:

[T]he 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.

*Id.*

<sup>82</sup> *See* Hirsch, *supra* note \_\_\_\_\_, at 6-7 n.18 and authorities cited therein

<sup>83</sup> A substantial majority of states do not allow a spendthrift provision to bar claims of certain preferred creditors, such as child support and alimony claimants. *See supra* note \_\_\_\_\_ and accompanying text. "Ordinary creditors," in this context, refers to those creditors of a beneficiary who do not hold such a preferred status.

<sup>84</sup> *E.g.*, CAL. PROB. CODE § 15306.5 (West 1987) (permitting the trustee to distribute up to 25% of amounts otherwise to be distributed to the beneficiary to the beneficiary's judgment creditor, provided such amounts are not necessary for the support of the beneficiary and the beneficiary's dependents); CONN. GEN. STAT. ANN. § 52-321 (Supp. 2001) (income not designated for beneficiary's support reachable by beneficiary's creditors; such income designated for support of beneficiary or beneficiary's family reachable by beneficiary's creditors only to the extent it exceeds amounts required for support of beneficiary and beneficiary's family); MICH. COMP. LAWS ANN. § 555.13 (1988) (rents and profits from real property in excess of amount necessary for beneficiary's education and support subject to beneficiary's creditors' claims); N.Y. EST. POWERS & TRUSTS LAW § 7-3.4 (McKinney 1992) (income in excess of amount necessary for the beneficiary's education and support subject to claims of beneficiary's creditors); N.D. CENT. CODE ANN. § 59-03-10 (1995) (rents and profits from real property in excess of amount necessary for beneficiary's education and support subject to beneficiary's creditors' claims); OKLA. STAT. ANN. tit. 60, § 140 (1994) (rents and profits from real property in excess of amount necessary for beneficiary's education and support subject to beneficiary's creditors' claims); S.D. CODIFIED LAWS § 43-10-13 (Michie 1997) (income beyond sum necessary for beneficiary's education and support subject to claims of beneficiary's creditors); VA. CODE ANN. § 55-19 (Michie Supp. 2000) (spendthrift protection afforded trusts not exceeding \$1,000,000 in value). At least one state, however, has repealed a statute allowing beneficiaries' creditors to reach surplus income. MINN. STAT. § 501.14 (repealed 1990).

<sup>85</sup> *See, e.g.*, IIA FRATCHER, *supra* note \_\_\_\_\_, at 92; GRISWOLD, *supra* note \_\_\_\_\_, at 639 – 40; Emanuel, *supra* note \_\_\_\_\_, at 182, 209; Richard R. Powell, *The Rule Against Perpetuities and Spendthrift Trusts in New York: Comments and Suggestions*, 71 COLUM. L. REV. 688, 704 – 05 (1971); William H. Wicker, *Spendthrift Trusts*, 10 GONZ. L. REV. 1, 16 (1974).

The U.T.C. drafters, however, elected not to follow that approach. Rather, under the U.T.C. a spendthrift provision generally will bar ordinary creditors of a trust beneficiary from reaching the beneficiary's interest in the trust without regard to the size of the trust, the amount of income it generates for distribution to the beneficiary/debtor, or the needs of the beneficiary.<sup>86</sup> As is the case with the alternative of simply holding spendthrift provisions invalid, there is no discussion in the published descriptions of the drafting of the U.T.C. of the possibility of limiting the extent to which a spendthrift provision would be effective against the claims of ordinary creditors of a trust beneficiary.<sup>87</sup> Had the drafters chosen to follow that approach, it would have been necessary to address a variety of issues. For example, would the protected amount of income for the beneficiary be defined relative to the beneficiary's need for support?<sup>88</sup> If so, how would the beneficiary's support needs be determined?<sup>89</sup> Would the needs of the

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<sup>86</sup> U.T.C. § 502(c). As discussed *supra* note \_\_\_\_\_, distributions from a spendthrift trust lose their protection from creditors' claims when the beneficiary receives them. Similarly, under the U.T.C., the beneficiary's creditors also may reach assets the trustee is required to distribute to a beneficiary/debtor but retains beyond a reasonable time. See U.T.C. § 506 discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>87</sup> See *supra* note \_\_\_\_\_.

<sup>88</sup> *E.g.*, N.Y. EST. POWERS & TRUSTS LAW § 7-3.4 (McKinney 1992) (income in excess of amount necessary for the beneficiary's education and support subject to claims of beneficiary's creditors).

<sup>89</sup> Under the much criticized "station-in-life" test that has been used in New York, the court determines the beneficiary's support needs giving consideration to, among other things, the beneficiary's accustomed standard of living. See, *e.g.*, *Moulton v. de ma Carty*, 6. Rob. 533 (N.Y. 1866) (no surplus income; beneficiary lived a life of leisure and had "refined tastes"). Perhaps the most strident critic of New York's station-in-life rule was Professor Gray:

To say that whatever money is given to a man cannot be taken by his creditors is bad enough; at any rate, however, it is law for rich and poor alike; but to say that from a sum which creditors can reach one man, who has lived simply and plainly, can deduct but a small sum, while a large sum may be deducted by another man because he is "of high social standing," or because "his associations are chiefly with men of leisure," or because he "is connected with a number of clubs," is to descend to a depth of as shameless snobbishness as any into which the justice of a country was ever plunged.

GRAY, *supra* note \_\_\_\_\_, at xi. For a discussion of the station-in-life rule and its demise, see BOGERT, BOGERT & HESS, *supra* note \_\_\_\_\_, § 227, at 516-19.

beneficiary's dependents be considered?<sup>90</sup> Or would the protected amount be defined not relative to the beneficiary's needs, but as a percentage of distributions otherwise due the beneficiary?<sup>91</sup> Another approach would be to limit the protection the spendthrift provision affords to a fixed amount of annual income.<sup>92</sup> Finally, a spendthrift statute could limit protection to a fixed amount of principal.<sup>93</sup>

Although these issues would have taken some effort to resolve, it is doubtful that their difficulty influenced the drafters' decision not to limit the protection afforded by spendthrift provisions against the claims of ordinary creditors of beneficiaries. Rather, the more likely explanation is that the drafters concluded that the policy considerations in favor of unlimited protection were stronger,<sup>94</sup> or that such a limitation likely would not have been acceptable to most state legislatures,<sup>95</sup> or some combination of the two.

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Under the Third Restatement, an accustomed-manner-of-living standard is appropriate for guiding a trustee in exercising its discretion to distribute for a beneficiary's support, but not for determining amounts creditors of a beneficiary of a non-spendthrift trust cannot reach because they are needed for the beneficiary's support. RESTATEMENT (THIRD) OF TRUSTS § 56 rep. notes on cmt. e, at 403 (Tentative Draft No. 2, 1999).

<sup>90</sup> Under New York's surplus income statute, it has been held that the protected income to which a beneficiary is entitled includes the expense of supporting the beneficiary's family. *Zinke v. Hipkins*, 233 N.Y. 516 (N.Y. 1922). Similarly, with respect to a trustee's administration of a trust for the beneficiary's benefit, the Restatement provides that "[a] support standard normally covers not only the beneficiary's own support but also that of persons for whom provision is customarily made as a part of the beneficiary's accustomed manner of living." RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d, at 304 (Tentative Draft No. 2, 1999). Moreover, if a trust is not subject to a spendthrift provision, a beneficiary's creditor may reach the beneficiary's interest, but the court may protect amounts necessary to meet the "actual needs" of the beneficiary and his or her family. *Id.* § 56 cmt. e, at 397.

<sup>91</sup> In California, judgment creditors of a spendthrift trust beneficiary may reach up to 25% of amounts otherwise to be distributed to the beneficiary, but only to the extent such amounts are not necessary for the support of the beneficiary and the beneficiary's dependents. CAL. PROB. CODE § 15306.5 (West 1987).

<sup>92</sup> *See, e.g.*, OKLA. STAT. ANN. tit. 60, § 175.25 (Supp. 2001) (\$25,000 per calendar year protected). An obvious problem with using a fixed amount is that over time, inflation will erode the real value of the protection the spendthrift provision affords, thus necessitating periodic amendments to the governing statute.

<sup>93</sup> *See, e.g.*, VA. CODE ANN. § 55-19 (Michie Supp. 2000) (spendthrift protection afforded trusts not exceeding \$1,000,000 in value). Again, unless an automatic inflation adjustment feature is built into the statute, it would require periodic amendments for the protected amount of principal to retain its real value.

<sup>94</sup> According to one commentator:

The fourth alternative with respect to the validity of spendthrift provisions -- simply holding them valid without limitation<sup>96</sup> -- was rejected, at least in part, because the claims of certain creditors are viewed as sufficiently compelling to outweigh the considerations favoring the spendthrift bar.<sup>97</sup> Thus, the U.T.C. drafters opted for the alternative of enforcing spendthrift provisions against ordinary creditors of the beneficiaries without limitation, but not against creditors granted preferred status. The fundamental question raised by this approach, of course, was deciding which creditors' claims would be enforceable against the beneficiaries' trust interests despite the existence of a spendthrift provision.<sup>98</sup> According to the U.T.C.'s reporter, in making that determination, "the drafting committee did not start from scratch, but rather paid particular attention to the exceptions listed in Restatement (Second) of Trusts § 157 and Restatement (Third) of Trusts § 59."<sup>99</sup> As discussed below, however, the U.T.C.'s

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If our only concern were to protect the state from public charges, we would have no reason to condone spendthrift trusts generating incomes above the level of welfare support; but as we have seen, additional interests lie at stake. The amount in question has no bearing on the paternal, socializing, protective, security, or value maintenance functions of voluntary and involuntary restraints. (Footnote acknowledging the additional policy of giving effect to testamentary intent omitted.)

Hirsch, *supra* note \_\_\_\_, at notes 277-78. For discussions of the policy considerations in favor of and against the general validity of spendthrift provisions, see the sources listed in note \_\_\_\_, *supra*.

<sup>95</sup> As described in note \_\_\_\_, *supra*, spendthrift provisions are generally valid in substantially all jurisdictions. Thus, although the eight states listed in note \_\_\_\_, *supra*, limit the ability of a spendthrift provision to protect the interests of trust beneficiaries from the claims of their ordinary creditors, they represent a substantial minority. Like the U.T.C., the Restatement does not limit the protection spendthrift provisions afford against the claims of beneficiaries' ordinary creditors, RESTATEMENT (THIRD) OF TRUSTS § 58 (Tentative Draft No. 2, 1999), and notes that: "The vast majority of decisions in this country . . . have accepted the spendthrift trust doctrine essentially as stated above in [§ 58] . . . . A few statutes contain significant departures from the rules stated here, such as . . . limiting the extent of the protection allowed (e.g., to the beneficiary's support)." *Id.* § 58 cmt. a.

<sup>96</sup> As discussed in note \_\_\_\_, *supra*, in no jurisdiction are spendthrift provisions valid without limitation.

<sup>97</sup> See generally English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_, at 30; Young, *supra* note

<sup>98</sup> See generally English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_, at 30.

<sup>99</sup> *Id.*



drafters departed made significant departures from the approach taken in the Restatements.

Under the Second Restatement, the claims of four classes of creditors are enforceable against a debtor/beneficiary's trust interest without regard to whether the trust instrument includes a spendthrift provision<sup>100</sup>: (i) child support and alimony claimants, (ii) those who have furnished necessary services or supplies to the beneficiary,<sup>101</sup> (iii) those whose claims arise from services or materials furnished to preserve or benefit the beneficiary's interest in the trust,<sup>102</sup> and (iv) the United States or a state.<sup>103</sup> Under the Third Restatement, creditors whose claims are not barred by a spendthrift provision include child support and alimony claimants and those with claims against the beneficiary for providing services or supplies for necessities or for the protection of the beneficiary's interest in the trust.<sup>104</sup> Under both Restatements, the list of exceptions is not exclusive.<sup>105</sup>

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<sup>100</sup> See generally RESTATEMENT (SECOND) OF TRUSTS § 157 (1959).

<sup>101</sup> Examples include providers of medical care, food, clothing, and lodging. *Id.* § 57 cmt. c, illus. 3, 4 (1959).

<sup>102</sup> Examples include attorneys who represent beneficiaries in challenges to the validity of the trust and persons who repair or improve property of the trust at the behest of the beneficiary. *Id.* § 157 cmt. d, illus. 5, 6 (1959).

<sup>103</sup> Examples include tax claims arising from income of the trust that is taxable to the beneficiary, or income of the beneficiary from other sources. *Id.* § 157 cmt. e.

<sup>104</sup> RESTATEMENT (THIRD) OF TRUSTS § 59 (Tentative Draft No. 2, 1999). Note that under the Third Restatement, governmental claims are not expressly excepted from the spendthrift bar. Their omission from the list, however, does not imply that such claims are not enforceable against beneficiaries' interests in spendthrift trusts. Rather, the Third Restatement's drafters recognized that governmental (and other) claimants whose claims arise under federal law or a state statute may be enforced against the debtor/beneficiary's interest in a spendthrift trust to the extent so provided by applicable law. *Id.* § 59 cmt.

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<sup>105</sup> RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. a (1959); RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a (Tentative Draft No. 2, 1999). For a discussion, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

The exceptions to spendthrift protection under the U.T.C. are set forth in section 503:

(b) Even if a trust contains a spendthrift provision, a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary.

(c) A spendthrift provision is unenforceable against a claim of this State or the United States to the extent a statute of this State or federal law so provides.<sup>106</sup>

Most noteworthy about section 503 are that (i) it does not include an exception for claims by providers of necessary services or supplies to the beneficiary, and (ii) it is an exclusive list that precludes any other claimants from being able to reach the beneficiary's interest in the trust.

Under the Restatement, persons who provide necessities to or for the benefit of trust beneficiaries may reach their interests in the trust regardless of whether the instrument includes a spendthrift provision.<sup>107</sup> Examples of such necessities claims are those of a physician who provided the beneficiary with medical services, or a creditor who provided the beneficiary with food, clothing or lodging.<sup>108</sup> Such claims are enforceable, despite the presence of a spendthrift provision, because barring such claims

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<sup>106</sup> U.T.C. § 503.

<sup>107</sup> RESTATEMENT (THIRD) OF TRUSTS § 59(b) (Tentative Draft No. 2, 1999).

<sup>108</sup> RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. c illus. 3, 4 (1959). A claimant who acts officiously in providing necessary goods or services, however, may not reach the beneficiary's interest in a spendthrift trust. *Id.* § 157 cmt. c; IIA FRATCHER, *supra* note \_\_\_\_\_, at 203-04. Neither may a provider of necessities recover from a beneficiary's interest in a spendthrift trust to the extent the claim is excessive in amount. RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. c (Tentative Draft No. 2, 1999).

“would tend to undermine the beneficiary’s ability to obtain necessary goods and assistance; and a refusal to enforce such claims is not essential to a settlor’s purpose of protecting the beneficiary.”<sup>109</sup> Rather, enforcing such claims may further the settlor’s purposes – protecting the beneficiary against his or her own improvidence and assuring the beneficiary of a means of support – in establishing the trust.<sup>110</sup>

Professor English, the U.T.C. Reporter, has provided the following explanation for the absence of a necessities exception to the spendthrift bar in the U.T.C.:

Even though the necessities doctrine was perhaps originally derived with the greengrocer in mind, today it is used almost exclusively by government agencies seeking reimbursement for the costs of providing care or to deny eligibility for Medicaid on the theory that the beneficiary’s interest in trust is an available resource. Sophisticated drafting normally can protect a trust from government claims and result in the exclusion of the trust as an available resource. Absent such sophisticated counsel, however, a necessities exception would be largely a trap for the unwary. Recognizing the important role that third party trusts play in assuring an enhanced quality of life for individuals with disabilities, the drafting committee elected not to create an exception to the spendthrift bar for providers of necessities. If government agencies are to obtain reimbursement for the costs of care, they must rely on other law.<sup>111</sup>

In rejecting the necessities exception, the U.T.C. departs not only from the Restatements,<sup>112</sup> but also from legislative trends and recent cases.<sup>113</sup> By doing so, it

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<sup>109</sup> RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. c (Tentative Draft No. 2, 1999).

<sup>110</sup> IIA FRATCHER, *supra* note \_\_\_\_\_, at 201-02.

<sup>111</sup> English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 31.

<sup>112</sup> Note that the U.T.C. was drafted in coordination with the revision of the Restatement of the Law of Trusts that began in the late 1980s, is still underway, and is resulting in the Restatement (Third) of Trusts. English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 25-26. As a result, many U.T.C. provisions are consistent with comparable provisions of the Third Restatement. *Id.* at 26. The treatment of the claims of creditors who provide necessities to spendthrift beneficiaries is a notable exception.

<sup>113</sup> RESTATEMENT (THIRD) OF TRUSTS § 59 rep. notes on cmts. c, d, at 481 (Tentative Draft No. 2, 1999) (citing CALIF. CIV. PROC. CODE § 706.051(c); KY. REV. STAT. § 381.180; 60 OKLA. STAT. ANN. § 175.25; WASH. CODE ANN. STAT. § 11.96.150 (1998) (repealed January 2000, but recodified in § 11.96A.190

forecloses not only claims of government agencies seeking reimbursement for the costs of providing care, but also claims of other providers of necessities. As suggested by Professor English, however, in recent years there have been few reported cases in which creditors have relied on the necessities exception in an attempt to reach assets in a spendthrift trust for a debtor/beneficiary.<sup>114</sup>

While the U.T.C.'s omission of a necessities exception to the spendthrift bar may help a trust beneficiary avoid a governmental agency's claim for reimbursement for the costs of providing care to the beneficiary,<sup>115</sup> it should have little or no effect on what is perhaps the most significant issue with respect to trust beneficiaries and public assistance: whether the assets or income of a trust for the beneficiary disqualify an otherwise qualified beneficiary from receiving Medicaid benefits, including the cost of long-term nursing home care.<sup>116</sup> To ensure that Medicaid benefits are available only to

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(Supp. 2001)); *Sisters of Mercy Health Corp. v. First Bank of Whiting*, 624 N.E.2d 520 (Ind. Ct. App. 1993)). See also GA. CODE ANN. § 53-12-28 (1997); LA. REV. STAT. ANN. § 9:2005(2) (West 1991).

<sup>114</sup> For cases in which such claims were made successfully, see *Erickson v. Bank of California, N.A.*, 643 P.2d 670 (Wash. 1982) (necessities included "doctors, ambulance services, telephone services, utilities and hospitals"); *In re Dodge's Estate*, 281 N.W.2d 447 (Iowa 1979) (nursing home expenses); and *Sisters of Mercy Health Corp. v. First Bank of Whiting*, 624 N.E.2d 520 (Ind. Ct. App. 1993) (hospital care). By contrast, the exception was not applicable to the claim of a guardian for fees for services provided to the ward (whose food, clothing, and shelter were provided by the trustee) in the form of doing grocery shopping for the ward, taking the ward to lunch, and taking the ward on vacation. *In re Estate of McInerny*, 682 N.E.2d 284, 290 (Ill. App. Ct. 1997). If the trust includes a spendthrift clause and provides for distributions for the beneficiary's support, a necessities provider may also need to show that it was not within the trustee's discretion to withhold payment for the goods provided or services rendered. *Dodge*, *supra*, at 451; cf *Erickson*, *supra*, at 674.

<sup>115</sup> See *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>116</sup> Medicaid is a "federal-state partnership designed to assist needy individuals within participating states to obtain medical care." Barbara J. Collins, *Medicaid Eligibility and Coverage for Elderly and Disabled Clients: Overview and Update*, 12TH ANNUAL ELDER LAW INSTITUTE REPRESENTING THE ELDERLY CLIENT OF MODEST MEANS (P.L.I. New York Practice Skills Course Handbook Series No. F0-006P) June 2000 available at 75 PLI/NY 39, 41. Construing the relevant provisions of the statutes, rules, and regulations governing the Medicaid program is a daunting task:

There can be no doubt but that the statutes and provisions in question, involving the financing of Medicare and Medicaid, are among the most completely impenetrable

the needy, the Medicaid rules provide that a person is not eligible for them unless he or she has income and resources below relatively low specified amounts.<sup>117</sup> If the income and assets of a trust of which a prospective Medicaid recipient is a beneficiary are counted for eligibility purposes, the beneficiary often will not qualify for Medicaid benefits unless and until most or all of the trust assets have been dissipated.

Whether the income and assets of a trust for the beneficiary will be counted in determining his or her eligibility for Medicaid benefits depends on a variety of factors, an important one of which is whether the beneficiary (or his or her spouse) or a third party was the settlor of the trust.<sup>118</sup> Subject to several exceptions, the assets and income of a trust of which the beneficiary also is the settlor<sup>119</sup> will be treated as belonging to the beneficiary, and thus usually will disqualify him or her from receiving Medicaid benefits.<sup>120</sup> For such self-settled trusts, the decision of the U.T.C.'s drafters not to

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texts within human experience. Indeed, one approaches them at the level of specificity herein demanded with dread, for not only are they dense reading of the most tortuous kind, but Congress also revisits the area frequently, generously cutting and pruning in the process and making any solid grasp of the matters addressed merely a passing phase.

*Rehab. Ass'n of Virginia, Inc. v. Kozlowski*, 42 F.3d 1444, 1450 (4th Cir. 1994).

<sup>117</sup> See Collins, *supra* note \_\_\_\_\_, at 46-49.

<sup>118</sup> See generally, CLIFTON B. KRUSE, JR., *THIRD PARTY AND SELF-CREATED TRUSTS - PLANNING FOR THE ELDERLY AND DISABLED CLIENT* (2d ed. 1998).

<sup>119</sup> Whether a beneficiary of a trust should be treated as its settlor for this purpose is not always clear. There are many cases in which the nominal settlor of a trust is a court, conservator, or guardian, or the tortfeasor responsible for injuries to the beneficiary, or its insurance carrier, and the trust is funded with the beneficiary's assets, or the proceeds of a claim belonging to the beneficiary. See *id.* at 154-55 n.131-33 (citing cases involving such circumstances). In some of those cases, the trust assets have not disqualified the beneficiary from Medicaid benefits, while in others the opposite conclusion has been reached. *Id.* Arguably, the enactment of the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93") has foreclosed the ability of such trusts to protect assets from the reach of Medicaid providers. See *id.*, at 15. See also *STATEMENT (THIRD) OF TRUSTS* § 50 rep. notes on cmt. e, at 358-59 (Tentative Draft No. 2, 1999).

<sup>120</sup> If the settlor of a trust retains the power to revoke it, its assets and income will be treated for Medicaid qualification purposes as the assets and income of the settlor. 42 U.S.C. § 1396p(d)(3)(A) (1994). If the trust is irrevocable and the settlor is a beneficiary, generally its assets and income will be treated as belonging to the settlor/beneficiary to the maximum extent that the trustee may distribute the income and corpus to or for the benefit of the settlor. 42 U.S.C. § 1396p(d)(3)(B) (1994). Three exceptions to this rule were created by OBRA 93: income-assignment trusts, 42 U.S.C. § 1396(d)(4)(B) (1994); pooled-account

include a necessities exception to the spendthrift bar should have no effect on a beneficiary's qualification for Medicaid, because OBRA 93 prescribes the treatment of such trusts for Medicaid purposes without regard to whether the trust instrument includes a spendthrift provision or whether the jurisdiction excepts claims of necessities providers from spendthrift protection.<sup>121</sup>

The decision not to include a necessities exception to the spendthrift bar also should have little or no effect on whether a beneficiary of a third-party created trust<sup>122</sup> will qualify or continue to qualify for Medicaid assistance. Generally, as mentioned, Medicaid qualification depends on whether the prospective recipient meets income and resource eligibility requirements.<sup>123</sup> With respect to assets held in trust for the benefit of a Medicaid applicant, the qualification issue is whether the beneficiary's interest in the trust is such that its assets or income should be counted as available to the beneficiary.<sup>124</sup> If so, the beneficiary usually will not qualify for Medicaid benefits; if not, and the

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trusts, 42 U.S.C. § 1396p(d)(4)(C) (1994); and trusts for disabled persons not yet age sixty-five, 42 U.S.C. § 1396p(d)(4)(A) (1994). *See generally* KRUSE, *supra* note \_\_\_\_\_, at 9-13. Each of these trusts may be created by a disabled settlor with the settlor's own assets for the settlor's own benefit, without disqualifying the settlor for Medicaid benefits. *Id.* at 9-10. Note, however, that to accomplish that result, each of them must provide that at the settlor's death, an amount equal to the benefits the settlor received from the state's Medicaid program must either be repaid to the state or, with respect to a pooled-account trust, to the charitable entity that managed the pooled account trust. *Id.*

<sup>121</sup> Note also that the U.T.C. provides no protection with respect to creditors' claims asserted against trust interests of settlor/beneficiaries. *See* U.T.C. § 505 discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>122</sup> For purposes of determining whether assets in trust for a beneficiary, or the income they earn, will disqualify the beneficiary from receiving Medicaid benefits, a trust created by a "third party" generally is one created by "an individual who is not obligated to pay all or any part of expenditures necessary for the medical assistance of" the beneficiary. *See* KRUSE, *supra* note \_\_\_\_\_, at 23 n.\*.

<sup>123</sup> *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>124</sup> *See infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

beneficiary's other assets and income do not exceed the limits, the beneficiary will qualify.<sup>125</sup>

The determination of whether the assets or income of a trust are available to the beneficiary for Medicaid qualification purposes is not affected by whether the trust instrument includes a spendthrift provision or whether such a provision applies to necessities providers. Rather, the effect of a spendthrift provision is to preclude a creditor (whose claim is not excepted from the spendthrift bar) from reaching either the beneficiary's interest in the trust, or a distribution by the trustee before its receipt by the beneficiary.<sup>126</sup> A necessities exception simply allows creditors who have provided necessities to the beneficiary to reach all or part of the trust assets held by the trustee that otherwise are distributable to the beneficiary.<sup>127</sup> In short, a spendthrift provision does not define the extent of a beneficiary's interest in a trust, and thus does not affect the determination of whether the beneficiary's interest is sufficient to constitute either a right to income or an available resource for Medicaid qualification purposes.

Accordingly, the omission from section 503 of a necessities exception to the spendthrift

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<sup>125</sup> For example, if the trust instrument directs the trustee to make current distributions of income to the beneficiary, or provides the beneficiary with the right to withdraw principal from the trust for the beneficiary's support, the trust income or assets will be deemed available to the beneficiary, but that generally will not be the case if distributions to the beneficiary are at the trustee's discretion. *See* KRUSE, *supra* note \_\_\_\_, at \_\_\_\_.

<sup>126</sup> U.T.C. § 502(c).

<sup>127</sup> *See* U.T.C. § 501 discussed at notes \_\_\_\_ - \_\_\_\_ and accompanying text. Under the U.T.C., the anticipated effect of a creditor obtaining a final order attaching a beneficiary's interest that is not protected by a spendthrift provision is as follows: "the trustee will then pay to the creditor instead of to the beneficiary any payments the trustee would otherwise be required to make to the beneficiary, as well as discretionary distributions the trustee decides to make." *Id.* § 501 cmt.

bar should have no effect on whether trust beneficiaries will qualify for Medicaid assistance.<sup>128</sup>

The omission of a necessities exception to spendthrift protection, however, could help a trust beneficiary defeat a claim by a provider of Medicaid benefits for reimbursement for the cost of care provided to the beneficiary. For example, assume that a person who had been receiving Medicaid benefits becomes a beneficiary of a spendthrift trust under which he or she is entitled to receive current distributions of income. Assume also that the Medicaid provider attempts to recover amounts previously paid for the beneficiary's care from his or her interest in the trust. If the instrument does not include a spendthrift provision, or if claims of necessities providers are not barred by it, the provider presumably would be able to reach the beneficiary's interest in the trust to satisfy its reimbursement claim.<sup>129</sup> If, however, the trust instrument includes a spendthrift provision and there is no necessities exception to its bar, the provider will be unable to reach distributions prior to their receipt by the beneficiary.<sup>130</sup> Further, to avoid claims by creditors against distributions made or payable to the beneficiary from a spendthrift trust, the trustee may be able to make distributions by applying amounts otherwise distributable to the beneficiary directly for the beneficiary's benefit.<sup>131</sup>

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<sup>128</sup> For a discussion of the effect of section 504 of the U.T.C., which governs the rights of creditors of beneficiaries of discretionary trusts, on the ability of beneficiaries of third-party created trusts to qualify for Medicaid benefits, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>129</sup> U.T.C. § 501.

<sup>130</sup> U.T.C. § 502(c). Of course, after a distribution has been made, the spendthrift provision will provide no protection against collection actions taken by the creditor against the beneficiary. See *supra* note \_\_\_\_\_. Further, the creditor's claim may not be avoided by the trustee withholding distributions that, under the trust instrument, are due to be made to the beneficiary. See U.T.C. § 506 discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>131</sup> If, as is common, the trust instrument provides for distributions for the benefit of the beneficiary, as well as to the beneficiary, the trustee should be able to satisfy its distribution obligation by directly paying



The absence of a necessities spendthrift exception under the U.T.C. may also help a trust beneficiary who is receiving public assistance continue to receive benefits from the trust. For example, “supplemental needs trusts” are discretionary trusts that are commonly used to provide supplemental benefits to disabled individuals whose basic support is provided by the government, without disqualifying them from receiving their basic support from public assistance.<sup>132</sup> If the jurisdiction excepts the claims of necessities providers from the spendthrift bar (or in the event that the trust instrument does not include a spendthrift provision), the government agency providing support to

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creditors the beneficiary wants to be paid. *See* RESTATEMENT (THIRD) OF TRUSTS § 49 cmt. a, at 272 (Tentative Draft No. 2, 1999) (with respect to determining the extent of the interest of a trust beneficiary, “[t]he terms of the trust . . . will be respected and given effect unless contrary to public policy”). If the terms of the trust do not explicitly authorize distributions to be made to others for the beneficiary’s benefit, they may nevertheless be allowable. In such a case, presumably the beneficiary would have acquiesced in the indirect distributions. The Restatement contemplates that such distributions may be made by the trustee, although not in the context of a creditor avoidance motivation. *See id.* § 49 cmt. c, at 277 (“[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.”). Note, however, that the U.T.C.’s explicit authorization of a trustee to make distributions for the benefit of a beneficiary, instead of directly to the beneficiary, applies only “to a beneficiary who is under a legal disability or who the trustee reasonably believes is incapacitated . . .” U.T.C. § 816(21).

<sup>132</sup> A supplemental needs trust has been described as one that:

. . . specifically limits a trustee’s discretion with respect to distributions from the trust in order to meet the needs of the disabled beneficiary not provided for by governmentally-funded programs. A proper supplemental needs trust provides that the purpose of the trust is to improve upon the beneficiary’s quality of life by providing for those supplemental needs, such as more sophisticated medical, rehabilitative, recreational or educational aid, not provided by other sources of assistance, including governmental assistance. The trustee’s distribution discretion is limited to considering all other funds available to meet the beneficiary’s needs, including governmental assistance. The trustee is prohibited from making distributions for basic support provided under governmental assistance programs. Therefore, a [supplemental needs trust] should not be counted under the asset test for Medicaid, but actual income distributions from the trust will be counted under the income test.

Craig P. Goldman, *Render unto Caesar That Which is Rightfully Caesar’s, but not a Penny more than You Have To: Supplemental Needs Trusts in Minnesota*, 23 WM. MITCHELL L. REV. 639, 662 (1997) (footnotes omitted). *See also* Gail C. Eichstadt, Essay, *Using Trusts to Provide for the Needs of an Adult Child with a Disability: An Introduction to Family Concerns for Lawyers and a Primer on Trusts for Parents*, 45 S.D. L. REV. 622 (2000); Scott Gardner, Comment, *Supplemental Needs Trusts: A Means to Conserve Family*

the beneficiary could attempt to force the trustee to pay to the agency part or all of any amounts the trustee decides in its discretion to distribute to or for the benefit of the beneficiary for his or her supplemental needs.<sup>133</sup> While such a claim might be unsuccessful or meet with only limited success,<sup>134</sup> the decision of the U.T.C. drafters to exclude the necessities exception from section 503 avoids the issue entirely for trusts that include spendthrift provisions.

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*Assets and Provide Increased Quality of Life for the Disabled Family Member*, 32 DUQ. L. REV. 555 (1994).

<sup>133</sup> Under the U.T.C. and the Restatement, a creditor of a beneficiary of a trust that does not include a spendthrift provision, or a creditor whose claim is excepted from the protection a spendthrift provision affords, may reach distributions that otherwise would be made to or for the benefit of the beneficiary. U.T.C. § 501; RESTATEMENT (THIRD) OF TRUSTS § 60 (Tentative Draft No. 2, 1999).

<sup>134</sup> Under the U.T.C., if the trust does not include a spendthrift provision, or if a creditor's claim is excepted from the spendthrift bar, the court issuing an order allowing a creditor to reach the beneficiary's interest in the trust "may limit the award to such relief as is appropriate under the circumstances." U.T.C. § 501. Similarly, under the Restatement, "if an expressed or implied purpose of the discretionary interest is to provide for the beneficiary's support, health care, or education, in establishing the portion of each distribution allocated to the payment of claims the court is to take account of the beneficiary's actual needs in maintaining a reasonable level of support, care, and education." RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. c, at 485-86 (Tentative Draft No. 2, 1999). *See also id.* § 60 cmt. e, at 397 (with respect to non-discretionary trusts, "[t]he 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"). With respect to how such an "actual needs" standard would be applied in the context of a claim being made by a Medicaid agency against the interest of a beneficiary of a supplemental needs trust, most if not all of the benefits provided by a such a trust would seem to constitute actual needs of the beneficiary that a court would allow the trustee to meet in determining the creditor's ability to reach discretionary distributions. For example, a supplemental needs trust can be used to provide dental care; plastic, cosmetic surgery or non-necessary medical procedures; psychological support services; recreation and transportation; differentials in cost between housing and shelter for shared and private rooms; supplemental nursing care; telephone and television services; an electric wheelchair and other mobility aids; a mechanical bed; periodic outings and vacations, including costs incurred by caretaker companions; hair and nail care; stamps and writing supplies; more sophisticated medical, dental or diagnostic treatments, including experimental treatment, for which funds are not otherwise available; private rehabilitative training; payments to bring in family and friends for visitation if the trustee deems that appropriate and reasonable; private case management to assist the beneficiary, or to aid the trustee in the trustee's duties; medication or drugs prescribed by a physician; and drug and/or alcohol treatment. Eichstadt, *supra* note \_\_\_\_\_, at 634-35. Furthermore, if it were determined that some of the items discretionary distributions were to provide were not covered by an applicable "actual needs" standard, the result likely would be that the trustee would not exercise its discretion to make any further distributions for those items. Thus, as a practical matter there would not appear to be much incentive for a Medicaid provider to attempt to reach discretionary distributions from supplemental needs trusts regardless of the presence or absence of a spendthrift provision or a necessities exception to the protection it affords.

As mentioned,<sup>135</sup> under the U.T.C., a creditor of a beneficiary of a spendthrift trust may not reach the beneficiary's interest in the trust, or distributions by the trustee before their receipt by the beneficiary, except when: (i) the creditor is a child, spouse, or former spouse of the beneficiary who has a judgment or court order for support or maintenance; (ii) the creditor has a judgment for amounts due for having provided services for the protection of the beneficiary's interest in the trust; or (iii) the creditor is a state or the United States, and under a state statute or federal law the governmental claim is not barred by the spendthrift provision.<sup>136</sup> Except when the beneficiary also is a settlor of the trust,<sup>137</sup> or when the trustee withholds a distribution it is required to make to the beneficiary for more than a reasonable period of time,<sup>138</sup> no other creditors of the beneficiary may reach the beneficiary's interest, or a distribution by the trustee before the beneficiary receives it, regardless of the nature of their claims.<sup>139</sup> By contrast, both the Second<sup>140</sup> and Third<sup>141</sup> Restatements provide that their lists of spendthrift exceptions are not exclusive. Rather, according to the Third Restatement, "special circumstances or evolving policy may justify recognition of other exceptions, allowing the beneficiary's interest to be reached by certain creditors in appropriate circumstances."<sup>142</sup>

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<sup>135</sup> See *supra* note \_\_\_\_\_ and accompanying text.

<sup>136</sup> U.T.C. §§ 502, 503.

<sup>137</sup> See U.T.C. § 505 discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>138</sup> See U.T.C. § 506 discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>139</sup> "[E]xcept 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." U.T.C. § 502(c). The only provisions of the U.T.C. providing to the contrary are those of section 503, dealing with claims for child or spousal support, claims for services protecting the beneficiary's interest in the trust, and claims of the state or federal government; section 505, dealing with claims against a beneficiary who also was a settlor of the trust; and section 506, dealing with overdue distributions.

<sup>140</sup> RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. a (1959).

<sup>141</sup> RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a (Tentative Draft No. 2, 1999).

<sup>142</sup> *Id.*

Of particular significance with respect to the question of whether other kinds of creditors' claims should be excepted from the spendthrift bar is whether a tort claimant should be able to reach the interest of a tortfeasor/beneficiary in a spendthrift trust.<sup>143</sup> For years, commentators have favored a tort claimant exception to spendthrift protection.<sup>144</sup> A commonly expressed rationale for such an exception<sup>145</sup> is that a fundamental policy consideration favoring the validity of spendthrift provisions – that persons who extend credit may protect themselves by properly investigating the

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<sup>143</sup> Under the Restatement, a spendthrift provision also will not prevent a set-off against a beneficiary's interest of amounts due from a beneficiary who served as trustee and caused harm to the trust estate and the interests of other beneficiaries by breaching a fiduciary duty. *Id.*; RESTATEMENT (SECOND) OF TRUSTS, § 257 (1959). Neither the Second nor the Third Restatement includes in its comments an explanation of the rationale for this additional spendthrift exception, but under the Second Restatement, it is available only if the settlor has not manifested a different intention. *Id.* A commentator justifies the set-off exception "in order to prevent damage to the interests of other beneficiaries." BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 224, at 474. Allowing such a set-off, however, implicitly treats the claims of other trust beneficiaries as superior to those of ordinary creditors of the beneficiary/trustee who breached a fiduciary duty.

The question of whether a spendthrift provision will foreclose a set-off against the interest of a beneficiary/trustee who has breached a fiduciary duty is not addressed directly by the U.T.C. *See* U.T.C. §§ 502, 503, 1001. Arguably, the U.T.C. does not permit such a set-off because when a trust instrument includes a valid spendthrift provision, "except as otherwise provided in this [article] a creditor . . . of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary," U.T.C. § 502(c), and, as noted, no other provision of Article V excepts claims for a set-off from a spendthrift bar. Further, the U.T.C.'s list of remedies available to beneficiaries when the trustee has breached a fiduciary duty does not include a set-off. U.T.C. § 1001. Although that list is not exclusive, but is instead "supplemented by the common law of trusts and principles of equity," *see* U.T.C. § 1001 cmt. a, set-off probably will not be available when the trust instrument includes a valid spendthrift provision. Under section 107, "[t]he common law of trusts and principles of equity supplement this [Code], except to the extent modified by this [Code]." U.T.C. § 107. Thus, even if there is a set-off exception to the spendthrift bar under the common law of trusts or principles of equity, the explicit statement of the effect of a spendthrift provision in section 502(c), and the explicit exceptions to the effectiveness of a spendthrift provision set forth in sections 503, 505, and 506, apparently will preclude additional exceptions from the common law or principles of equity.

<sup>144</sup> *See, e.g.*, BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 224, at 478-79; IIA FRATCHER, *supra* note \_\_\_\_, at 220 – 22; GRISWOLD, *supra* note \_\_\_\_, at 442-44, 648 (providing a model statute); William N. Antonis, Note, *Spendthrift Trusts, Attachability of a Beneficiary's Interests in Satisfaction of a Tort Claim*, 28 NOTRE DAME LAW. 509 (1952); Laurene M. Brooks, Comment, *A Tort-Creditor Exception to the Spendthrift Trust Doctrine: A Call to the Wisconsin Legislature*, 73 MARQ. L. REV. 109 (1989); George P. Costigan, Jr., *Those Protective Trusts Which Are Miscalled "Spendthrift Trusts"* Reexamined, 22 CAL. L. REV. 471 (1934); Frank A. Gregory, Note, *Trusts: Tort Claims as an Exception to the Spendthrift Trust Doctrine*, 17 OKLA. L. REV. 235 (1964). For a recent argument against recognizing such an exception, see Charles D. Fox IV & Rosalie Murphy, *Are Spendthrift Trusts Vulnerable to a Beneficiary's Tort Creditors?*, TRUSTS & EST. February 1998, at 57.

<sup>145</sup> *See, e.g.*, GRISWOLD, *supra* note \_\_\_\_, at 443.

creditworthiness of those who seek credit from them<sup>146</sup> – is not applicable to creditors whose claims against the beneficiary arise out of the commission of a tort by the beneficiary.<sup>147</sup> On that basis, tort creditors arguably should be treated like spousal and child support claimants, who also do not voluntarily extend credit to the beneficiary.<sup>148</sup>

Although there are spendthrift statutes in two states – Georgia and Louisiana – that except at least some tort claimants from the spendthrift bar,<sup>149</sup> most courts that have

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<sup>146</sup> See, e.g., *Nichols v. Eaton*, 91 U.S. 716, 726 (1875).

<sup>147</sup> According to Professor Scott:

[T]he situation of a tort creditor is quite different from that of a contract creditor. A man who is about to be knocked down by an automobile has no opportunity to investigate the credit of the driver of the automobile and has no opportunity to avoid being injured no matter what the resources of the driver may be...[T]here seems to be something rather shocking in the notion that a man should be allowed to continue in the enjoyment of property without satisfying the claims of persons whom he has injured.

IIA FRATCHER, *supra* note \_\_\_\_\_, at 220.

<sup>148</sup> See *Sligh v. First Nat'l Bank of Holmes County*, 704 So. 2d 1020 (Miss. 1997); BOGERT, BOGERT & HESS, *supra* note \_\_\_\_\_, § 222, at 387; Hirsch, *supra* note \_\_\_\_\_, at 78-80. Note, however, that the involuntary nature of the claim of a victim of a tort arguably should not be enough to warrant excepting all tort claims from the spendthrift bar. Rather, if a tort claim exception were to be recognized, the nature of the beneficiary's conduct could be determinative of whether a particular claim could be made successfully. For example, Professor Scott's treatise asserts that "a distinction might well be made between situations in which the beneficiary was at fault and those in which tort liability is imposed by law although there is no fault, as in cases of absolute liability, strict liability for products, and liability under the doctrine of respondeat superior for torts committed by a servant, such as a driver employed by an elderly beneficiary. . . ." IIA FRATCHER, *supra* note \_\_\_\_\_, § 157.5 n.1, at 222. Moreover, for a tort claim to avoid being barred by a spendthrift provision the Restatement suggests requiring more than a finding that the beneficiary was simply at fault: "The nature or a pattern of tortious conduct by a beneficiary...may on policy grounds justify a court's refusal to allow spendthrift immunity to protect the trust interest and the lifestyle of that beneficiary, especially one whose willful or fraudulent conduct or persistently reckless behavior causes serious harm to others." RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a (Tentative Draft No. 2, 1999). However the line were drawn, there undoubtedly would be cases for which difficult, time-consuming, and expensive case-by-case determinations of which side of it a beneficiary's conduct fell on would have to be made. For a proposal to avoid such disputes by making one-third of any distribution of principal or income to a beneficiary from a spendthrift trust reachable by the beneficiary's creditors, without regard to the nature of their claims, see Emanuel, *supra* note \_\_\_\_\_, at 206-09.

<sup>149</sup> See GA. CODE ANN. § 53-12-28 (1997) (excepting tort judgment claims from the protection of a spendthrift provision unless "the beneficiary . . . has a medically determined physical or mental disability that substantially impairs the beneficiary's ability to provide for the beneficiary's care or custody and constitutes a substantial handicap . . ."); LA. REV. STAT. ANN. § 9:2005 (West 1991) (allowing the creditor of a trust beneficiary to reach the beneficiary's interest in the income or principal of the trust in the court's "discretion and as may be just under the circumstances if the claim is based on a judgment for: ... (3) An

been asked to create such an exception have declined to do so.<sup>150</sup> A notable exception is the 1997 decision of the Mississippi Supreme Court in *Sligh v. First National Bank of Holmes County*.<sup>151</sup> In *Sligh*, a spendthrift trust beneficiary, who was uninsured and driving under the influence of alcohol, caused an accident in which one of the plaintiffs suffered severe injuries, including a broken spine that left him paralyzed.<sup>152</sup> The injured plaintiff and his wife first obtained default judgments against the beneficiary, who as a result of the accident had been convicted of the felony of driving under the influence and causing bodily injury to another,<sup>153</sup> and who had no assets other than his interest in two spendthrift trusts his mother had created for his benefit for his lifetime.<sup>154</sup> Next, the plaintiffs sued to garnish the tortfeasor's beneficial interests in the trusts to partially satisfy their judgments against him.<sup>155</sup>

In holding for the plaintiffs in a 7 to 2 decision,<sup>156</sup> the majority opinion addressed three policy considerations that had led Mississippi courts to uphold spendthrift clauses.<sup>157</sup> First, with

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offense or quasi-offense committed by the beneficiary or by a person for whose acts the beneficiary is individually responsible.”).

<sup>150</sup> See, e.g., *Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 493 U.S. 365 (1990); *Helmsley-Spear, Inc. v. Winter*, 426 N.Y.S.2d 778 (N.Y. 1980); *United Mine Workers of Am. v. Boyle*, 567 F.2d 112 (D.C. Cir. 1977); *Davies v. Harrison*, 3 Pa. D. & C. 481 (Pa. 1923). For contrary holdings in the context of claims made against the accounts of participants in retirement plans covered by the Employee Retirement Income Security Act of 1974, which includes anti-alienation spendthrift provisions, see *Crawford v. La Boucherie Bernard Ltd.*, 815 F.2d 117 (D.C. Cir. 1987) and *St. Paul Fire & Marine Ins. Co. v. Cox*, 752 F.2d 550 (11th Cir. 1985).

<sup>151</sup> 704 So. 2d 1020 (Miss. 1997).

<sup>152</sup> *Id.* at 1022. The plaintiff's injuries included the “loss of the use of both legs, loss of all sexual functions and loss of the ability to control bowel and urinary functions.” *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> The plaintiffs obtained default judgments against the tortfeasor/beneficiary in the aggregate amount of \$5,000,000. *Id.* The trusts' assets totaled approximately \$314,000. *Id.* at 1023.

<sup>156</sup> The court's decision in *Sligh* went well beyond holding that the trusts' spendthrift provisions did not prevent the plaintiffs from reaching the tortfeasor's beneficial interests in the trusts. The trust instruments did not provide for mandatory distributions of income or principal to the tortfeasor/beneficiary, but instead gave the trustee the discretion to make distributions of income and principal in his best interest. *Id.* at

respect to the responsibility of creditors to protect themselves by making themselves aware of their debtors' spendthrift trust protections, the court concluded that because tort claimants do not voluntarily extend credit to spendthrift trust beneficiaries, that policy consideration simply was not applicable to tort judgment creditors.<sup>158</sup> Second, although enforcing spendthrift provisions protects the beneficiaries of trusts from becoming impoverished burdens on the public, doing so may make the victim of a beneficiary/tortfeasor a pauper.<sup>159</sup> According to the court: "If one must choose whom to reduce to personal pauperism in such a case, the spendthrift tortfeasor or the innocent tort judgment creditor, we are inclined to choose the party at fault, especially where that fault rises to the level of gross negligence or intentional conduct."<sup>160</sup> Finally, the court addressed the right of owners of property to dispose of it as they wish, which the court characterized as "[p]erhaps the most important policy consideration in favor of enforcing spendthrift trust provisions":<sup>161</sup>

Clearly, the right of donors to place restrictions on the disposition of their property is not absolute, for . . . there are several generally recognized exceptions to the spendthrift trust doctrine. Rather, a donor may dispose of his property as he sees fit so long as such disposition does not violate the law or public policy. We find that it is indeed against public policy to dispose of property in such a way that the beneficiary may enjoy the income from such property without fear that

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1022-23. (For a summary of the limitations on the ability of a creditor of a beneficiary of a discretionary trust to reach the beneficiary's interest in the trust under the U.T.C., see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.) Each trust instrument also named two remainder beneficiaries. *Sligh*, 704 So. 2d at 1023. Despite not only the spendthrift provisions, but also the discretionary nature of the trusts and the interests of the remainder beneficiaries, the court held that all of the trusts' assets were subject to the plaintiffs' claims. *Id.* at 1029.

<sup>157</sup> *Id.* at 1027-28.

<sup>158</sup> *Id.* at 1027.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 1028

his interest may be attached to satisfy the claims of his gross negligence or intentional torts.<sup>162</sup>

The spendthrift exception created by *Sligh* did not remain the law in Mississippi for long. A year after *Sligh* was decided, it effectively was overturned by the absence of a tort claimant exception to the validity of spendthrift trusts under the Family Trust Preservation Act of 1998.<sup>163</sup> Despite the reversal of *Sligh* by the Mississippi legislature, the decision, along with that of the Supreme Court of Iowa in *In re Estate of Nagel*,<sup>164</sup> has been said to “show that there may be evolution in the range of spendthrift trust protection.”<sup>165</sup> The U.T.C. approach of codifying spendthrift protection, subject only to specifically defined exceptions,<sup>166</sup> however, appears to put an end to the possibility of tort claimants being able to reach the beneficial interests of tortfeasors in spendthrift trusts in adopting jurisdictions.<sup>167</sup>

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<sup>162</sup> *Id.* The court further noted that deterring intentional torts and acts of gross negligence is important enough to warrant the imposition of punitive damages, but that “the intended deterrent effect would be completely lost upon individuals whose interests are immune from the satisfaction of such claims.” *Id.*

<sup>163</sup> MISS. CODE ANN. § 91-9-507 (Supp. 2000). The speed with which the Mississippi legislature acted to overturn *Sligh* has been characterized by Professor Halbach as “almost amusing.” Edward C. Halbach, Jr., *Uniform Acts, Restatements, and Trends in American Trust Law at Century’s End*, 88 CAL. L. REV. 1877, 1894 (2000).

<sup>164</sup> 580 N.W.2d 810 (Iowa 1998). In *Nagel*, the tortfeasor and his wife were settlors of a revocable trust that became irrevocable at their deaths in the accident that gave rise to the plaintiff’s claim against the trust assets. *Id.* at 810. The opinion, which does not address whether the trust instrument included a spendthrift provision, holds that the plaintiff’s claim against the settlor may be satisfied by assets in the trust despite it having become irrevocable, causing the remainder beneficiaries’ interests to vest, by the settlors’ deaths. *Id.* at 812.

<sup>165</sup> A. JAMES CASNER & JEFFREY N. PENNELL, ESTATE PLANNING §4.1.4 n.22 (6th ed. 1994). As noted by Professor Pennell, because in *Nagel* the trust assets clearly would have been reachable had the settlor lived until the judgment was presented for collection, it is of limited significance with respect to the question whether a tort claimant of a trust beneficiary may reach assets in the trust. *Id.*

<sup>166</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>167</sup> In *Scheffel v. Krueger*, 2001 WL 839850 (N.H. July 26, 2001), the beneficiary of a spendthrift trust created by his grandmother was charged with, *id.* at \*1, and apparently convicted and imprisoned for, sexually assaulting a minor child. *Id.* at \*3. The minor’s mother sued the beneficiary, alleging that he had “sexually assaulted her minor child, videotaped the act, and later broadcasted the videotape over the Internet.” *Id.* at \*1. After obtaining a default judgment for more than \$550,000, the plaintiff sought to attach the defendant’s interest in the spendthrift trust. *Id.* In affirming the lower court’s dismissal of the plaintiff’s action against the trust, the New Hampshire Supreme Court noted that by statute in New



## V. U.T.C. Section 504: Discretionary Trusts

The basic rules of U.T.C. section 504, which governs the rights of creditors of beneficiaries of discretionary trusts,<sup>168</sup> are easily summarized. First, section 504 is equally applicable to trusts under which the settlor has provided standards to guide the trustee in exercising its discretion to make distributions to beneficiaries and to trusts under which no such guidance is provided.<sup>169</sup> Second, even if a trustee has not complied with a standard of distribution or has abused a discretion, the only creditors of a discretionary trust beneficiary who may compel a distribution are the beneficiary's child,

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Hampshire, spendthrift provisions preclude attachment of beneficiaries' interests by their creditors except in two specified circumstances, neither of which was applicable to the plaintiff's claim. *Id.* at \*2. In response to the plaintiff's argument that the legislature did not intend the statute to protect spendthrift trust beneficiaries from their tort creditors, the court noted that "[w]here the legislature has made specific exemptions, we must presume no others were intended." *Id.* Finally, the court also rejected the plaintiff's public policy argument that it should create a tort creditor exception to the statute: "In this State, the legislature has enacted a statute repudiating the public policy exception sought by the plaintiff. . . . This statutory enactment cannot be overruled, because '[I]t is axiomatic that courts do not question the wisdom or expediency of a statute.'" *Id.* (As of the date of this writing, the opinion in *Scheffel* "has not been released for publication in the permanent law reports. Until released, it is subject to revision or withdrawal." *Id.* at \*1.).

<sup>168</sup> With respect to discretionary trusts generally, see RESTATEMENT (THIRD) OF TRUSTS § 50 (Tentative Draft No. 2, 1999); Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425 (1961).

<sup>169</sup> U.T.C. § 504. Traditionally, support trusts and discretionary trusts have been treated differently for a variety of purposes. For example, under the Second Restatement, creditors of a beneficiary of a discretionary trust may not compel distributions, but certain creditors of a support trust can. RESTATEMENT (SECOND) OF TRUSTS §§ 154, 155 (1959). Under the Third Restatement, the "artificial, unworkable distinction between 'support' and 'discretionary' trusts is discarded..." RESTATEMENT (THIRD) OF TRUSTS, Reporter's Memorandum to the Members of the Institute (Tentative Draft No. 2, 1999). Thus, the Third Restatement provision addressing the transfer or attachment of a beneficiary's discretionary interest "applies where trustees are granted discretionary authority over benefits, regardless of whether the trust terms provide simply for the beneficiary's support, provide other or additional standards, or express no standards to limit or guide the trustee's exercise of discretion." *Id.* § 60 cmt. a, at 484. For a discussion of the Restatement's abandonment of the distinction between discretionary and support trusts, see RESTATEMENT (THIRD) OF TRUSTS § 60 rep. notes on cmt. a, at 496-99 (Tentative Draft No. 2, 1999).

spouse, or former spouse in whose favor a judgment or court order has been issued for support or maintenance.<sup>170</sup> Third, the portion of a discretionary distribution that should have been made to the beneficiary that instead may be reached by such a creditor is the amount that is “equitable under the circumstances.”<sup>171</sup> Finally, the fact that most creditors of a discretionary trust beneficiary may not compel a distribution on the basis of an abuse of discretion by the trustee in failing to make the distribution does not limit the right of the beneficiary to do so.<sup>172</sup>

Absent from the U.T.C. are express provisions addressing the situation of a discretionary beneficiary, who was not the settlor of the trust, but who serves as its trustee.<sup>173</sup> In such a case, the Restatement rule is similar to that applicable when the settlor is a discretionary beneficiary: the trustee-beneficiary’s creditors may “reach from time to time the maximum amount the trustee-beneficiary can properly take.”<sup>174</sup> The analysis of whether that is the case under the U.T.C. begins with the rule that “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....”<sup>175</sup> Because the property of a revocable trust is subject to the claims of the

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<sup>170</sup> U.T.C. § 504(a), (b).

<sup>171</sup> U.T.C. § 504(c)(2). *See supra* note \_\_\_\_\_ and accompanying text.

<sup>172</sup> U.T.C. § 504(c).

<sup>173</sup> *See generally* Richard A. Oshins & Steven J. Oshins, *Protecting & Preserving Wealth Into the Next Millenium*, (pt. 1) TRUSTS & EST., Sept. 1998, at 52.

<sup>174</sup> RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. g, at 493 (Tentative Draft No. 2, 1999). The comment goes on to note that “[a]s in other nonsettlor-beneficiary situations, the court may reserve a portion of that amount for the beneficiary’s actual needs for reasonable support, health care, and education . . . .” *Id.* For a discussion of the rules applicable when the settlor is a discretionary beneficiary of a trust, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>175</sup> U.T.C. § 505(b)(1).

settlor's creditors during his or her lifetime,<sup>176</sup> the creditors of a trustee-beneficiary will be able to reach the assets of the trust that the trustee-beneficiary could distribute to the trustee-beneficiary if his or her power to make such distributions constitutes a "power of withdrawal" within the meaning of section 505(b)(1). A "power of withdrawal" is defined by the U.T.C. 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."<sup>177</sup> Although the term "presently exercisable general power of appointment" is not defined by the U.T.C., the Restatement refers to such a power as one "by which the property may be appointed to the donee,"<sup>178</sup> and notes that a trustee-beneficiary's "rights and authority represent a limited form of ownership equivalence analogous to certain general powers . . ."<sup>179</sup> Further, powers of appointment may be held in a fiduciary as well as in a non-fiduciary capacity.<sup>180</sup> Accordingly, it appears that the Restatement rule allowing the creditors of a trustee-beneficiary to reach the maximum amount he or she can properly take from the trust also should be the result under the U.T.C.

To illustrate operation of the rules of section 504 outside the trustee-beneficiary context, consider a trust under which the trustee is given the discretion to make distributions of income and principal to the beneficiary. Assume that a creditor has a claim against the beneficiary and that the claim is not based on a judgment or court order for support or maintenance of the beneficiary's child, spouse, or former spouse. Under

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<sup>176</sup> U.T.C. § 505(a)(1).

<sup>177</sup> U.T.C. § 103(10).

<sup>178</sup> RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. b, at 395 (Tentative Draft No. 2, 1999).

<sup>179</sup> *Id.* § 60 cmt. g., at 493.

<sup>180</sup> RESTATEMENT (SECOND) OF PROPERTY: DONATIVE TRANSFERS § 11.1 cmt. a (1986). More specifically, a "trustee holding a discretionary power has a power of appointment." *Id.* § 11.1 cmt. d.

the U.T.C., the creditor may not compel a distribution to the beneficiary from the trust that the creditor could then reach (on the theory, for example, that it is in the beneficiary's best interest to provide the beneficiary with funds to pay his or her obligations and thus avoid litigation and possible bankruptcy).<sup>181</sup> If the creditor is the beneficiary's child, spouse, or former spouse, whose claim is reflected by a judgment or court order for support or maintenance, however, the creditor may compel a distribution, but only if he or she can show that the trustee has not complied with a standard of distribution or has abused its discretion.<sup>182</sup> In such a case, the court may order the trustee to make a distribution to satisfy, or partially satisfy, the judgment or court order.<sup>183</sup> Such an order of distribution would direct the trustee to pay 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 the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion."<sup>184</sup>

The U.T.C. does not address the question of what a preferred family creditor (i.e., a child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance) would have to show to establish that by deciding not to make a distribution to the beneficiary that the creditor could reach, the

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<sup>181</sup> U.T.C. § 504(b). Note that this apparently will be the case even if the creditor's claim is for goods or services the trustee is specifically authorized to provide. Thus, for example, if the trustee is authorized to make distributions for the beneficiary's education, an educational institution the beneficiary attends apparently may not compel distributions it can reach to satisfy amounts owed to the institution by the beneficiary for tuition, room and board, and fees.

<sup>182</sup> U.T.C. § 504(c).

<sup>183</sup> U.T.C. § 504(c)(1).

<sup>184</sup> U.T.C. § 504(c)(2). In determining the amount that is "equitable under the circumstances," *id.*, "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." U.T.C. § 504 cmt.

trustee had abused its discretion or failed to comply with a standard of distribution. At least if the trust instrument authorizes distributions for the beneficiary's "support" or "maintenance,"<sup>185</sup> under the Restatement a failure to make the distribution, at least with respect to the beneficiary's current spouse and minor children, may constitute an abuse of discretion because "[a] beneficiary's right to distributions for 'support' usually includes amounts appropriate to the support of certain dependents (see § 50, Comment d). The general policy favoring such creditors is properly to be taken into account in this context."<sup>186</sup>

Of more difficulty for a preferred family creditor seeking to establish that the trustee's failure to make a distribution was an abuse of discretion would be a trust that provides no standards for distributions, or provides a standard that does not include the beneficiary's support.<sup>187</sup> In such a case, the Restatement provides that the exercise of the trustee's discretion will be subject to a good-faith standard, "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."<sup>188</sup>

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<sup>185</sup> The Restatement refers to a "support" or "maintenance" standard as "[p]robably the most common guides used in grants of discretion." RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d, at 301 (Tentative Draft No. 2, 1999). If the trust instrument does not expressly provide a support standard for distributions to the beneficiary, but provides for distributions for the beneficiary's "comfort," "benefit," "best interests," or "welfare," under the Restatement a support standard will be implied. *Id.* at 305-06.

<sup>186</sup> *Id.* § 60 cmt. e, at 490. The referenced comment provides that the beneficiary's "support" covers the support of the beneficiary's current spouse and minor children, even if they do not live with the beneficiary, if the beneficiary chooses or is required to provide for their support. *Id.* § 50 cmt. d, at 304. But whether the beneficiary's "support" covers his or her "support obligation to a former spouse would normally be within the trustee's reasonable discretion." *Id.* § 50.

<sup>187</sup> Consider, for example, a trust instrument authorizing the trustee to make distributions for the beneficiary's "education." Although, such a standard includes living expenses of the beneficiary while he or she is attending school, *id.* § 50 cmt. d, at 303, presumably it would not include distributions for the beneficiary's support if he or she is not doing so.

<sup>188</sup> *Id.* § 50, at 300.

Furthermore, “[a] court will not interfere with a trustee’s exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust. Thus, judicial intervention is not warranted merely because the court would have differently exercised the discretion.”<sup>189</sup> Accordingly, if a trust instrument does not expressly or impliedly provide a support standard for distributions to a beneficiary, a child, spouse, or former spouse with a court order or judgment against the beneficiary for support or maintenance may not be able to make the abuse-of-discretion showing that is necessary to compel a distribution under section 504 that he or she could reach.<sup>190</sup>

Because the claims of preferred family creditors are not barred by spendthrift provisions,<sup>191</sup> it will be of no consequence to such a creditor whether a trust of which the debtor is a beneficiary includes a spendthrift provision. Furthermore, the rules of section 504 apply even if the trust instrument does not include a spendthrift provision.<sup>192</sup> That is not to say, however, that it is of no consequence whether an instrument creating a discretionary trust includes a spendthrift provision. Rather, including a spendthrift provision in a discretionary trust provides significant additional protection to a beneficiary with respect to the claims of creditors other than preferred family creditors. Without a spendthrift provision, creditors of the beneficiary may attach “present or

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<sup>189</sup> *Id.* § 50 cmt. b, at 294.

<sup>190</sup> Note also that the extent to which the beneficiary would or would not benefit personally from a distribution may be considered in determining whether a trustee has abused its discretion by failing to make a distribution a creditor could reach. *See infra* note \_\_\_\_.

<sup>191</sup> U.T.C. § 503(b).

<sup>192</sup> U.T.C. § 504(b).

future distributions to or for the benefit of the beneficiary,”<sup>193</sup> that must then be paid to the creditor.<sup>194</sup> By contrast, if a spendthrift provision is included in the instrument, creditors who are subject to it<sup>195</sup> “may not reach the . . . distribution . . . before its receipt by the beneficiary.”<sup>196</sup> Accordingly, if a discretionary trust also is a spendthrift trust, ordinary creditors of a beneficiary may not prevent the trustee from making discretionary distributions to or for the benefit of the beneficiary. Rather, such creditors’ recourse is to try to reach such distributions in the hands of the beneficiary.<sup>197</sup>

Another issue with respect to section 504 is what effect, if any, it will have on the ability of beneficiaries of discretionary trusts to qualify for Medicaid or other public assistance, and on the ability of the providers of public assistance to recoup the costs of such care from the trust assets.<sup>198</sup> With respect to the qualification issue, if a Medicaid applicant is a beneficiary of a trust, the question is whether the assets or income of the trust are “available” to the applicant, in which case they will be counted in determining if the applicant meets the income and resource eligibility tests.<sup>199</sup> If the

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<sup>193</sup> U.T.C. § 501.

<sup>194</sup> *Id.* § 501 cmt. For a pre-U.P.C. case reaching that result with respect to discretionary distributions, see *Hamilton v. Drogo*, 150 N.E. 496 (N.Y. 1926). Note, however, that the U.T.C. provides that if a creditor attaches the beneficiary’s interest, “[t]he court may limit the award to such relief as is appropriate under the circumstances.” U.T.C. § 501; see *supra* note \_\_\_\_\_ and accompanying text.

<sup>195</sup> For a list of creditors whose claims are not subject to a spendthrift bar, see *supra* note \_\_\_\_\_ and accompanying text. All other creditors’ claims are subject to a valid spendthrift provision. U.T.C. § 502(b).

<sup>196</sup> U.T.C. § 502(c).

<sup>197</sup> For a discussion of the ability this gives a trustee and beneficiary to avoid the beneficiary’s creditors, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>198</sup> For a discussion of the effect of the U.T.C.’s omission of a necessities exception to the spendthrift bar on those questions, see *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>199</sup> See 42 U.S.C. § 1396a(17)(B) (1994) (state Medicaid plans are required to take “into account only such income and resources as are . . . available to the applicant . . .”). In many jurisdictions, the trust assets will be treated as available if the trust is determined to be a “support” trust, but not if it is characterized as a “discretionary” trust. See, e.g., *Kryzsko v. Ramsey County Social Services*, 607 N.W.2d 237 (N.D. 2000);

applicant/beneficiary, or his or her spouse, is the settlor of the trust, OBRA 93 generally will treat its assets as available to the applicant, thus disqualifying him or her from receiving Medicaid benefits.<sup>200</sup> The more difficult question is whether the income or assets of a trust created by a third party will be treated as available to the beneficiary if he or she becomes a Medicaid applicant. Most of the cases on this issue fall into two groups: (i) those in which the settlor expressly states that the trust assets are to be used to provide for the beneficiary's supplemental needs, but not his or her support,<sup>201</sup> and (ii) those in which the settlor authorizes the trustee to provide for the beneficiary's support.<sup>202</sup>

With respect to the former, courts generally have held that the assets and income of such "supplemental needs trusts"<sup>203</sup> are not available to the beneficiary for purposes

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Estate of Ferguson, 483 N.W.2d 353 (Mich. 1992). In summarizing the court's analysis in *Kryzsko*, Professor Volkmer noted that:

the North Dakota court took the fairly standard approach that is used in many jurisdictions: If the trust is deemed a 'support' trust, the assets will be considered available resources. If, on the other hand, the trust is deemed a 'discretionary' trust, the trust assets will not be considered available resources.

Ronald R. Volkmer, *New Fiduciary Decisions: Eligibility of Trust Beneficiaries for Medicaid*, 27 EST. PLAN. 334, 337 (2000). See generally KRUSE, *supra* note \_\_\_\_\_, at 23-24. The difficulty with such an approach is that many trusts provide the trustee with discretion to make distributions for the beneficiary's support. For a discussion of the Medicaid qualification issues raised by discretionary support trusts, see *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. For a discussion of the elimination of the distinction between support and discretionary trusts under the Third Restatement and the U.T.C., see *supra* note \_\_\_\_\_ and accompanying text.

<sup>200</sup> For a brief discussion of the circumstances in which a settlor may be a beneficiary of the trust he or she creates without causing disqualification from Medicaid benefits, see *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>201</sup> See, e.g., *Young v. Ohio Dep't of Human Serv.*, 668 N.E.2d 908 (Ohio 1996).

<sup>202</sup> See e.g., *Estate of Rosenberg v. Dep't of Pub. Welfare*, 679 A.2d 767 (Pa. 1996).

<sup>203</sup> For a brief discussion of supplemental needs trusts see *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.



of determining his or her eligibility for public benefits.<sup>204</sup> In response to the argument that such trusts violate public policy,<sup>205</sup> a relatively early decision disagreed:

We know of no public policy to prohibit a person who is not liable for the support of a charity patient in a public institution, to give to the patient extra comforts or luxuries or, at need, necessities which the institution does not furnish, nor do we find a public policy to seize such gifts before the patient has received them.<sup>206</sup>

Further, to hold that a supplemental needs trust for a Medicaid applicant or recipient disqualifies the applicant/recipient from public assistance would “eliminate a necessary source for the satisfaction of the uncompensated realistic and reasonable needs of the chronically ill and otherwise institutionalized disabled.”<sup>207</sup>

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<sup>204</sup> See, e.g., *Young v. Ohio Dep’t of Human Serv.*, 668 N.E.2d 908 (Ohio 1996); *Hecker v. Stark County Soc. Serv. Bd.*, 527 N.W.2d 226 (N.D. 1994); *In re Leona Carlisle*, 498 N.W.2d 260 (Minn. Ct. App. 1993); *In re Estate of Carmer*, 530 N.Y.S.2d 88 (N.Y. 1988); *In re Wright’s Will*, 107 N.W.2d 146 (Wis. 1961). As a result of the ability of supplemental needs trusts, also referred to as “special needs trusts,” to make assets available for incapacitated beneficiaries without disqualifying them from receiving public benefits, such trusts have received much attention from the estate planning bar. See, e.g., Goldman, *supra* note \_\_\_\_; Gardner, *supra* note \_\_\_\_; KRUSE, *supra* note \_\_\_\_, at 37-45; Martha A. Churchill & Patricia E. Kefalas Dudek, *Adults with Disabilities: Prepare for the Future with a Special Needs Trust*, 79 MICH. B.J. 1360 (2000); Chadwick Allen Harp, *Estate Planning for the Disabled Beneficiary*, PROB. & PROP. March-April 1997, at 14; Ronald T. Staebell, *Securing the Future of a Child with a Disability*, TRUSTS & EST. August 2000, at 43; Patricia Tobin, *20/20 Foresight: Planning Ahead for Special Needs Trusts*, PROB. & PROP. May-June 1997, at 56.

<sup>205</sup> A dissenting opinion in a recent Ohio case makes the argument that supplemental needs trusts violate public policy in the following manner:

[T]o allow a trust to distribute income or principal for virtually any purpose except for purposes that would eliminate or reduce Medicaid is against public policy because it shifts the beneficiary’s financial responsibility to the taxpayers despite the fact the beneficiary has the financial means to pay for his or her medical expenses.

*Young v. Ohio Dep’t of Human Serv.*, 668 N.E.2d 908, 913 (Ohio 1996).

<sup>206</sup> *In re Wright’s Will*, 107 N.W.2d 146, 149 (Wis. 1961).

<sup>207</sup> KRUSE, *supra* note \_\_\_\_, at 45. See also *Tidrow v. Dir., Missouri St. Div. of Family Serv.*, 688 S.W.2d 9, 12 (Mo. Ct. App. 1985) (stating that to hold that assets in a discretionary trust are disqualifying available resources would “invite anyone, finding himself in the position of [the settlor] in the future to make no testamentary provision for a handicapped child.”).

In sharp contrast to cases involving supplemental needs trusts are cases in which a settlor has directed that trust assets be used to provide for the beneficiary's support, including institutional care.<sup>208</sup> In such cases, the trust assets will be treated as available resources of the beneficiary.<sup>209</sup> In addition, settlors occasionally authorize discretionary distributions without a support or other standard to guide the trustee's exercise of its discretion,<sup>210</sup> in which case the trust assets likely will not be treated as available to the beneficiary.<sup>211</sup> But the most difficult eligibility/availability cases are those in which the settlor authorizes the trustee, in its discretion, to make distributions for the beneficiary's support.<sup>212</sup> In such a case, are the trust assets and income available to the beneficiary for his or her support, thus disqualifying the beneficiary from receiving public assistance, or does the trustee's discretionary control over the trust assets and income mean that they are not available to the beneficiary? Because in many jurisdictions there is no public policy objection to creating a trust to provide benefits to a recipient of public assistance

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<sup>208</sup> See, e.g., *Hoelzer v. Blum*, 462 N.Y.S.2d 684 (N.Y. 1983) (direction that income be used for the settlor's disabled daughter's support and maintenance, including nursing home costs); *California Dep't of Mental Hygiene v. Bank of S.W. Nat'l Ass'n*, 354 S.W.2d 576 (Tex. 1962).

<sup>209</sup> See *supra* note \_\_\_\_.

<sup>210</sup> See, e.g., *Simpson v. Kansas Dep't of Soc. & Rehab. Serv.*, 906 P.2d 174 (Kan. Ct. App. 1995).

<sup>211</sup> *Id.* But according to at least one court, to avoid having the trust assets treated as available to the beneficiary, a settlor should "not be required to place blind faith in the uncontrolled discretion of . . . [the] trustee." *Lang v. Pennsylvania Dep't of Pub. Welfare*, 528 A.2d 1335, 1345 (Pa. 1987). Rather, at least when the trust has other beneficiaries:

a settlor is entitled to maintain some control by means of a support standard, and at the same time reasonable flexibility through a grant of considerable discretion to the trustee(s), to ensure his purpose of providing reasonable care to the beneficiary who is or may be institutionalized without effectively disinheriting the other members of his family.

*Lang*, 528 A.2d at 1345.

<sup>212</sup> As noted previously, "support" (and its synonym, "maintenance") probably are the most common standards used by settlors to guide trustees in making distribution decisions. See *supra* note \_\_\_\_\_. But distributions for support also are authorized by the use of language that permits distributions for other purposes. See *supra* note \_\_\_\_\_. See also KRUSE, *supra* note \_\_\_\_\_, at 28 (noting that maintenance distributions have been held to be mandated by the terms "for the benefit of," "needs," "illness, accident, [and] emergency," "pleasure or comfort," "proper care of," "illness, want, or need," "welfare and best-interests," "general well being," and "proper maintenance" (footnotes omitted)).

without affecting his or her eligibility to receive such assistance,<sup>213</sup> the availability determination for discretionary support trusts generally is based on the settlor's intent.<sup>214</sup> When the settlor expressly creates a supplemental needs trust, his or her intention is clear and, as discussed, the trust's assets and income will not disqualify the beneficiary from receiving public assistance.<sup>215</sup> But in many cases, courts have been called upon to determine the settlor's intention because it is unclear from the instrument.<sup>216</sup> The results

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<sup>213</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>214</sup> See KRUSE, *supra* note \_\_\_\_\_, at 27. If the question is whether a settlor would prefer (i) that the beneficiary's basic support needs be met by a public assistance program such as Medicaid, with the trust assets that otherwise would be used for the beneficiary's support to be maintained to meet other needs of the beneficiary or preserved for ultimate distribution to remainder beneficiaries, or (ii) that the trust assets be used to provide for the beneficiary's basic support, thus reducing the trustee's ability to meet other needs of the beneficiary and to make ultimate distribution to the remainder beneficiaries, the expectation today is that most settlors would prefer the former. Indeed, some courts have, at least in part, based their holdings that the assets of discretionary support trusts are not available to their beneficiaries for public assistance qualification purposes on such a finding. See, e.g., *In re Will of Scatamacchia*, 569 N.Y.S.2d 873, 874 (Sur. Nassau 1991) ("It is not plausible to ascribe to the decedent an intention to exhaust the fund she set aside for her son by allowing her trustees to pay for medical care he was entitled to receive free of charge"); *Maul v. Fitzgerald*, 432 N.Y.S.2d 282, 284 (N.Y. 1980) ("It would be divorced from reality of life to presume that [the settlor] would intend the amount of the trust to be paid to [the state] in preference to having society share the burden"). By contrast, the court's opinion in a 1985 Pennsylvania case holding that the assets in a discretionary support trust disqualified the beneficiary from receiving public benefits noted the administering agency's contention that to allow the trustee to conserve the trust's assets for the remainder beneficiaries would "forc[e] the beneficiary to resort to public welfare." *Stoudt v. Pennsylvania Dep't of Pub. Welfare*, 464 A.2d 665, 666 (Pa. Commw. Ct. 1983). Four years later, in holding that the assets of a discretionary support trust did not disqualify its beneficiary from public assistance, the Pennsylvania Supreme Court rejected that position: "The statutory policy of Pennsylvania . . . does not reflect this vision of public assistance as charity and the consequent assumption that a settlor intended to exhaust his family's patrimony before his beneficiary could take advantage of public funds." *Lang v. Pennsylvania Dep't of Pub. Welfare*, 528 A.2d 1335, 1342 (Pa. 1987) (footnote omitted). Twelve years later, the Pennsylvania Supreme Court, on facts it held distinguishable from those in *Lang*, held that a discretionary support trust for a beneficiary disqualified her from receiving public benefits. *Estate of Rosenberg v. Dep't of Pub. Welfare*, 679 A.2d 767 (Pa. 1996). In doing so, the court rejected the:

presumption that every testator intends his survivors to utilize public assistance if possible so that a testamentary trust instrument such as this must be interpreted so as to make the widow eligible for medical assistance benefits in order to maximize the inheritance of the remaindermen. Although *Lang* condemned the notion that receiving public assistance is shameful, we do not subscribe to the opposite notion, that receiving public assistance is the presumed goal of estate planning.

*Rosenberg*, 679 A.2d at 772.

<sup>215</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>216</sup> In *Commonwealth Bank and Trust Co. v. Pennsylvania Department of Public Welfare*, 598 A.2d 1279 (Pa. 1991), for example, the trust instrument authorized the trustees to distribute principal to the beneficiary "for her support and maintenance, including medical surgical, hospital, or other institutional

have been far from uniform, with many cases holding the assets and income of discretionary support trusts are not available to their beneficiaries,<sup>217</sup> and others holding that they are.<sup>218</sup> A commentator recently provided the following summary of the applicable case law:

[L]itigation has occurred where a trust settlor's intention has been unclear. Consequently, numerous courts construe intent from the language expressed in the trust instrument by the settlor. In come [sic] cases, courts have determined intent based upon the value of the trust corpus (a small corpus indicating a nonsupport intent) or from a presumed non-support intent for one beneficiary where the trust is created for multiple beneficiaries. Some cases have considered the existence of state support received by trust beneficiaries prior to the settlor's death as extrinsic evidence that the settlor presumed that this resource would continue. Courts interpreting language used by settlors and looking at extrinsic factors where trust language is ambiguous or unclear have not reached consistent results, however. Where the intent of the settlor is not clear, courts construe what the settlor intended, and conclusions have not been uniform.<sup>219</sup>

Under U.T.C. section 504, most creditors, including those who provide support to a trust 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."<sup>220</sup> Accordingly, in a U.T.C. jurisdiction, unless other law in the jurisdiction provides to the contrary,<sup>221</sup> a provider of Medicaid or other

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care," *id.*, at 1280, but it provided for the trustees to do so in their "uncontrolled discretion, . . . having in mind the income or principal that may be available to or for her from other sources . . ." *Id.* The court held the trust assets were available to the beneficiary, thus disqualifying her from receiving public assistance. *Id.* at 1282. The court's holding was based, in part, on a perceived distinction between "income and principal" available to the beneficiary, which the trustees were directed to consider in exercising their discretion, and public benefits, which the court characterized as a "resource," rather than "income or principal." *Id.*

<sup>217</sup> For a collection and discussion of such cases, see KRUSE, *supra* note \_\_\_\_\_, at 32-37, 40-43.

<sup>218</sup> *Id.* at 27-30.

<sup>219</sup> *Id.* at 26-27.

<sup>220</sup> U.T.C. § 504(b).

<sup>221</sup> See U.T.C. § 503(c). See also English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 31.

public benefits to a beneficiary of a discretionary trust created by a third party, including one with support or other standards for distributions, will be unable to force distributions from the trust that it could reach to reimburse it for benefits it had provided to the beneficiary.<sup>222</sup> Although discussed in the context of the decision by the U.T.C. drafters not to include a necessities exception to the spendthrift bar in section 503, that result apparently is intended.<sup>223</sup>

A more difficult question is what effect, if any, U.T.C. § 504(b) will have on the question of whether a beneficiary of a third-party created discretionary support trust will be disqualified from receiving public benefits because the assets or the income of the trust are available to the beneficiary.<sup>224</sup> Section 504(b) prohibits a beneficiary's support creditor from compelling a distribution.<sup>225</sup> Does it also prohibit a public support provider from claiming that the assets or income of the trust are available to the beneficiary for his or her support?<sup>226</sup> Such a claim, if successfully made, likely would cause the beneficiary not to qualify for public assistance and therefore could have the practical

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<sup>222</sup> Because the U.T.C. does not include a necessities exception to the spendthrift bar, if the trust instrument also includes a spendthrift provision, the public assistance provider also would be unable to collect from the trustee amounts the trustee is required, or chooses, to distribute to or for the benefit of the beneficiary. U.T.C. §§ 502(c), 503. *See supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text. While section 502(c) would not prevent the provider from reaching trust assets after their distribution to the beneficiary, *see supra* note \_\_\_\_, if the trustee makes distributions for the beneficiary's benefit by paying other creditors directly, the provider would be unable to reach those distributions. *See infra* notes \_\_\_\_ - \_\_\_\_ and accompanying text. If, however, a discretionary trust instrument does not include a spendthrift provision, a public assistance provider would be able to attach part or all of any distributions the trustee chooses to make, including distributions for the beneficiary's benefit, as well as distributions to the beneficiary. U.T.C. § 501; *see supra* notes \_\_\_\_ - \_\_\_\_, \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>223</sup> *See supra* text accompanying note \_\_\_\_.

<sup>224</sup> *See supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>225</sup> U.T.C. § 504(b).

<sup>226</sup> Note that although section 504(b) prohibits most creditors from compelling a distribution, even if the trustee has breached a fiduciary duty to the beneficiary in not making one, it 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." U.T.C. § 504(d).

effect of forcing the trustee to make distributions to provide for the beneficiary's support. Thus, an argument could be made that section 504(b) precludes a public support provider from asserting that the assets or income of a discretionary support trust are available to its beneficiary, thus disqualifying him or her from public assistance, because the practical effect of such a claim is to compel distributions from the trust for the beneficiary's support.

But a claim that a trust's assets are available to its beneficiary would not, in fact, be an action to compel a distribution; rather, it would be a part of the provider's determination of whether the beneficiary qualifies for public assistance. If benefits are denied, the result may be that the trustee will make distributions for the beneficiary's support,<sup>227</sup> but that does not transform the provider's action in claiming that the trust assets are available to the beneficiary into one to compel distributions. Further, section 504(b) prohibits "a creditor of a beneficiary" from compelling a distribution.<sup>228</sup> In the context of acting on a beneficiary's application for benefits, a public support provider is not a "creditor" of the beneficiary, as the beneficiary is not indebted to the provider. Accordingly, section 504(b) should not prevent public support providers from claiming that discretionary support trust beneficiaries are not entitled to benefits because the trust assets or income are available to them.

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<sup>227</sup> Other alternatives include a member of the beneficiary's family providing for the beneficiary's support, either by paying the cost of the care, or perhaps by taking care of the beneficiary in his or her home.

<sup>228</sup> U.T.C. § 504(b).

The question of whether the assets or income of a discretionary support trust are, in fact, available to a beneficiary, however, remains. If the beneficiary could compel distributions from the trust for his or her support, the trust assets likely would be available to the beneficiary, thus disqualifying him or her from receiving public benefits.<sup>229</sup> In that regard, it is clear under the U.T.C. that the beneficiary may pursue an action against the trustee for abuse of discretion or failure to comply with a standard for distribution, even though a support creditor could not compel a distribution on that basis.<sup>230</sup> But an acknowledgment of the beneficiary's right to pursue a claim for support distributions does not mean that in a given case, such a claim could be made successfully. Rather, if the trust instrument provides, for example, that the trustee, in its sole discretion, may make distributions of income and principal to or for the benefit of the beneficiary for his or her support, is it an abuse of discretion if the trustee decides not to make support distributions, instead relying on public assistance for the beneficiary's support? If so, the trust assets and income likely would be available to the beneficiary for public assistance qualification purposes; if not, they should not be.

The U.T.C. provides little guidance on the question of what constitutes an abuse of discretion in the context of distribution decisions made by a trustee of a discretionary trust.<sup>231</sup> Under section 814, regardless of the extent of the trustee's discretion, it will be

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<sup>229</sup> See *Simpson v. Kansas Dep't of Soc. and Rehab. Serv.*, 906 P.2d 174, 178 (Kan. Ct. App. 1995); *Tidrow v. Dir., Missouri St. Div. of Family Serv.*, 688 S.W.2d 9, 13 (Mo. Ct. App. 1985).

<sup>230</sup> U.T.C. § 504(d). Note the inconsistency in this regard between the U.T.C. and the view that "absent an effective spendthrift restriction, there is or should be an exact parallelism between the rights of the *cestui* in and to the trust estate and the rights of his or her creditors to reach the *cestui*'s equitable interest therein." Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273, 289 (1983).

<sup>231</sup> Note that under the Restatement, the trustee of a discretionary support trust generally may exercise its discretion so as not to disqualify a beneficiary from receiving public benefits:

required to exercise its discretion “in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.”<sup>232</sup> The decision of the trustee of a discretionary support trust not to make distributions for the support of a beneficiary who is a prospective recipient of public support should meet the good faith part of the test. Assuming the beneficiary qualifies for public support, such a decision would not jeopardize the beneficiary’s support, and it would preserve trust assets for his or her other needs and for other beneficiaries. For those reasons, the trustee’s decision not to make support distributions also should not violate the requirement of section 814 that the trustee exercise its discretionary authority with regard to the interests of the beneficiaries. The more difficult question is whether such a decision would meet the

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[T]o the extent consistent with the terms and purposes of the trust, and allowable by applicable benefits statutes . . . , the presumption is 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.

RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e, at 313 (Tentative Draft No. 2, 1999). More generally, the Restatement acknowledges that a creditor (or assignee) of a discretionary beneficiary is “entitled to judicial protection from abuse of discretion by the trustee,” but notes that:

[A] trustee’s refusal to make distributions might not constitute an abuse as against an assignee or creditor even when, under the standards applicable to the power, a decision to refuse distributions to the beneficiary might have constituted an abuse in the absence of the assignment or attachment. 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.

*Id.* § 60 cmt. e, at 488-89. Finally, in a change from prior Restatements, under the Third Restatement, the trustee generally is to take into account a beneficiary’s other resources in exercising its power to make discretionary distributions. *Id.* § 50 rep. notes on cmt. e, at 345-52.

<sup>232</sup> U.T.C. § 814(a). Similarly, according to the Restatement:

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.

RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c, at 297 (Tentative Draft No. 2, 1999).



requirement that the trustee's discretion be exercised "in accordance with the terms and purposes of the trust."<sup>233</sup>

When a settlor establishes a trust and authorizes the trustee to make distributions for a beneficiary's support, clearly a purpose of the trust is to provide a source of support for the beneficiary. But when the trustee is not directed to make support distributions, but instead is given the discretion to do so, is it a purpose of the settlor to provide for the beneficiary's support from the trust without regard to the availability of public benefits to provide such support? As previously discussed, under existing pre-U.T.C. law, courts have struggled with this question, although it usually is phrased in terms of the settlor's "intent" rather than his or her "purposes" in creating the trust.<sup>234</sup> When the settlor of a discretionary support trust does not make clear what his or her intent is, or purposes are, when the beneficiary could qualify for public assistance if the trust assets and income are not available, courts have been required to make that determination from the trust language and various extrinsic factors.<sup>235</sup> Because the U.T.C. provides no guidance for ascertaining the settlor's intent or purposes in such a circumstance, it should have little or no effect on the determination of whether the assets

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<sup>233</sup> U.T.C. § 814(a).

<sup>234</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>235</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text. For cases holding that the settlor of a discretionary support trust intended that the trust provide for the beneficiary's support without regard to whether public assistance otherwise would be available, see *In re Cooper's Will*, 349 N.Y.S.2d 613 (Sur. Monroe 1973), *In re Reuff's Will*, 151 N.Y.S.2d 464 (Sur. 1956) and *In re Lackmann's Estate*, 320 P.2d 186 (Cal. 1958), discussed in KRUSE, *supra* note \_\_\_\_, at 29-30. For a case holding that the settlor intended that the trustee's discretion allow it to withhold distributions for support if those distributions would supplant public benefits, see *Lang v. Pennsylvania Department of Public Welfare*, 528 A.2d 1335 (Pa. 1987).

and income of a discretionary support trust are available to its beneficiary so as to disqualify him or her from receiving public benefits.

## VI. U.T.C. Section 505: Claims Against the Settlor

The rights of creditors of the settlor of a trust are addressed in U.T.C. section 505.<sup>236</sup> Separate rules are provided for revocable<sup>237</sup> and irrevocable trusts.<sup>238</sup> With respect to revocable trusts, a further distinction is made between creditors who assert their claims during the settlor's lifetime,<sup>239</sup> and those who assert claims after the settlor's death.<sup>240</sup> With respect to irrevocable trusts, a distinction is made between such trusts in which the settlor retained a beneficial interest and those in which he or she did not.<sup>241</sup>

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<sup>236</sup> With respect to the threshold question of who is the "settlor" of a trust, the U.T.C. defines the term with reference to the person or persons who create or contribute property to the trust, U.T.C. § 103(14), but does not address other circumstances in which a beneficiary who does not actually convey property to the trust nevertheless should be treated as a settlor of the trust. For a discussion of such circumstances, see RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. f, at 427-28 (Tentative Draft No. 1, 1996).

<sup>237</sup> U.T.C. § 505(a)(1), (3). Under the U.T.C., a "revocable" trust is one that the settlor may revoke "without the consent of the trustee or a person holding an adverse interest." U.T.C. § 103(13). If the instrument does not state whether the trust is revocable or irrevocable, at common law it was irrevocable. *See* RESTATEMENT (SECOND) OF TRUSTS § 330 (1959). Under the U.T.C., the rule is the opposite: a trust created after its enactment will be revocable by the settlor unless the instrument expressly provides that it is irrevocable. U.T.C. § 602(a).

For tax planning purposes, persons – usually trust beneficiaries – sometimes are given a right (which is not expected to be exercised) to withdraw part or all of gifts the settlor makes to the trust. *See* HENKEL, *supra* note \_\_\_\_, ¶10.03[4]. Because the power of withdrawal is the functional equivalent of a power of revocation, U.T.C. § 505 cmt., the U.T.C. treats the power holder "in the same manner as the settlor of a revocable trust to the extent of the property subject to the power." U.T.C. § 505(b)(1). Upon the lapse, release, or waiver of the power of withdrawal, the power holder, who usually also is a beneficiary of the trust, normally would be treated as the settlor of a now irrevocable trust (but only with respect to the property that had been subject to the withdrawal right). *Id.* § 505 cmt. To avoid that result, the U.T.C. includes an additional provision under which the holder of such a tax motivated power of withdrawal who allowed it to lapse will not be so treated. U.T.C. § 505(b)(2).

<sup>238</sup> U.T.C. § 505(a)(2).

<sup>239</sup> U.T.C. § 505(a)(1).

<sup>240</sup> U.T.C. § 505(a)(3).

<sup>241</sup> *See infra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

Under the U.T.C., all of the assets of a revocable trust are subject to the claims of creditors of the settlor of the trust during his or her lifetime.<sup>242</sup> This simple, bright line rule is not dependent on whether the settlor directly retained a beneficial interest in the income or principal of the trust – the power to revoke is enough.<sup>243</sup> By contrast, at common law a settlor’s creditor could not reach a power of revocation reserved by a settlor and thus could not compel the settlor to revoke the trust.<sup>244</sup> Because a power of revocation gives the settlor the ability, exercisable unilaterally, to obtain unrestricted ownership of the trust’s assets by simply revoking the trust, the U.T.C.’s rule allowing creditors of the settlor access to assets in a trust the settlor may revoke during his or her lifetime is a sensible one.<sup>245</sup>

In decades past, in at least some jurisdictions the creditors of a settlor of a revocable trust that became irrevocable on the settlor’s death could not reach assets in the trust after the settlor’s death.<sup>246</sup> Under the U.T.C., the assets of such a trust may be reached not only by the deceased settlor’s creditors, as is the case under current law in most jurisdictions,<sup>247</sup> but also by those asserting claims for the costs of administering the

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<sup>242</sup> U.T.C. § 505(a)(1).

<sup>243</sup> *Id.*

<sup>244</sup> See RESTATEMENT (SECOND) OF TRUSTS § 330 cmt. o (1959). If, however, as is usually the case, the settlor of a revocable trust also reserved rights to the income and principal of the trust, the creditor could reach the maximum amount the trustee could distribute to or for the benefit of the settlor/beneficiary. *Id.* § 156.

<sup>245</sup> This rule is said to be “what is now a well accepted conclusion.” U.T.C. § 505 cmt. Note that even under Alaska’s new protective trust statute, a trust must be irrevocable to be protected from the settlor’s creditors. See *supra* note \_\_\_\_.

<sup>246</sup> See *Schofield v. Cleveland Trust Co.*, 21 N.E.2d 119 (Ohio 1939); RESTATEMENT (SECOND) OF TRUSTS § 330 cmt. o (1959).

<sup>247</sup> See, e.g., *In re Estate of Nagel*, 580 N.W.2d 810 (Iowa 1998); *In re Marriage of Perry*, 68 Cal. Rptr. 2d 445 (Cal. Ct. App. 1997); *State St. Bank & Trust Co. v. Reiser*, 389 N.E.2d 768 (Mass. App. Ct. 1979).

settlor's estate, the costs of the settlor's funeral, and statutory allowances for the settlor's spouse and children.<sup>248</sup> In each case, recovery may be had against the trust assets only if and to the extent that there are not sufficient assets in the settlor's probate estate to satisfy them.<sup>249</sup> Further, the right of such a claimant to reach the trust's assets is "subject to the settlor's right to direct the source from which liabilities will be paid..."<sup>250</sup> These provisions accommodate the common revocable trust/pourover will plan under which a settlor may shift liabilities his or her estate otherwise would have to the revocable trust.<sup>251</sup>

With respect to irrevocable trusts, if the settlor does not retain a beneficial interest in assets transferred to a trust (or violate the applicable jurisdiction's fraudulent conveyance statute<sup>252</sup>), his or her creditors will not be able to reach the trust assets.<sup>253</sup> In such a case, the settlor has no interest in the trust or its assets and thus no property interest a creditor could attach.<sup>254</sup> If the settlor retains a beneficial interest in the trust

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*See also* UNIF. PROBATE CODE § 6-102, 8 U.L.A. 463 (1998); RESTATEMENT (THIRD) OF TRUSTS § 25(2) cmt. e, at 521-22 (Tentative Draft No. 1, 1996); RESTATEMENT (SECOND) OF PROPERTY: DONATIVE TRANSFERS § 34.3(3) (1986).

<sup>248</sup> U.T.C. § 505(a)(3).

<sup>249</sup> *Id.*

<sup>250</sup> *Id.*

<sup>251</sup> U.T.C. § 505 cmt.

<sup>252</sup> *See* U.T.C. § 505 cmt. (noting that a settlor's creditor may have rights not only under the jurisdiction's law on fraudulent transfers, but also under the provisions for voidable preferences under federal bankruptcy law).

<sup>253</sup> Section 505 limits the amount of assets in the trust a creditor or assignee of the settlor may reach to the maximum amount the trustee may distribute to or for the benefit of the settlor. U.T.C. § 505(a)(2).

<sup>254</sup> If the settlor retained the ability to control the beneficial interests in the transferred assets, however, such as by serving as trustee and holding a broad power as such to make discretionary distributions to the trust's beneficiaries, transfers of assets to the trust would not be treated as completed gifts for federal gift tax purposes, *see* Treas. Reg. § 25.2511-2(b) 2001), and the assets in the trust at the settlor's death would be included in his or her estate for federal estate tax purposes. *See* IRC § 2036(a)(2) (1994).

assets, section 505(a)(2), consistent with the common law,<sup>255</sup> provides that without regard to whether the trust instrument includes a spendthrift provision, a creditor (or assignee) of the settlor may reach the maximum amount the trustee could distribute to or for the benefit of the settlor.<sup>256</sup>

Until the late 1990's, the prohibition on self-settled spendthrift trusts reflected in section 505(a)(2) was the law in most, if not all, jurisdictions.<sup>257</sup> In an effort to attract trust business,<sup>258</sup> Alaska<sup>259</sup> and Delaware,<sup>260</sup> in 1997, and Nevada<sup>261</sup> and Rhode Island,<sup>262</sup> in 1999, enacted statutes designed to, among other things,<sup>263</sup> allow the settlor

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<sup>255</sup> See RESTATEMENT (THIRD) OF TRUSTS § 58(2) (Tentative Draft No. 1, 1996) (spendthrift provision invalid with respect to beneficial interest retained by settlor); *id.* § 60 cmt. f (creditor of settlor/beneficiary of discretionary trust may reach maximum amount trustee properly could distribute to settlor/beneficiary).

<sup>256</sup> U.T.C. § 505(a)(2). Thus, “[s]hould the trustee have discretion to distribute the entire income and principal to the settlor, the effect of this subsection is to place the settlor’s creditors in the same position as if the trust had not been created.” *Id.* § 505 cmt. Note that the rule of section 505 is not to allow a settlor’s creditors to reach all of the trust assets simply because the settlor is a beneficiary of the trust. Rather, the creditor will be able to reach only the maximum amount the trustee could distribute to or for the benefit of the settlor. Thus, for example, if the settlor makes a transfer (that is not in fraud of creditors) to a third party trustee and authorizes the trustee to make distributions of income and principal for the settlor/beneficiary’s comfortable support and care, the settlor’s creditors “may attach her interest and thereby obtain the right to receive from time to time the maximum amount [the trustee] can properly distribute to [the settlor] ...” RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. f, illus. 8, at 492-93 (Tentative Draft No. 1, 1996). See; IIA FRATCHER, *supra* note \_\_\_\_\_, at 164-68; GRISWOLD, *supra* note \_\_\_\_\_, § 481.

<sup>257</sup> See Joseph G. Hodges, Jr. & Eugene P. Zuspann II, *Can Some Colorado Trusts Provide Protection From Claims of Creditors?*, COLO. LAW. Aug. 1999, at 61. A 1986 Missouri statute provides protection to settlors of self-settled spendthrift trusts, to the extent transfers to the trust were not fraudulent and certain other requirements are met. MO. REV. STAT. ANN. § 456.080 (Supp. 2001). The Missouri statute, however, “is not widely known, and Missouri has not been advertising as a debtor protection state.” Hodges & Zuspann, *supra*. Because Colorado’s statute allowing the creditors of a settlor to reach transfers in trust for the use of the settlor expressly applies only to existing creditors, it may provide protection for self-settled spendthrift trusts against the claims of creditors that arise after the transfers are made. See *id.*; COLO. REV. STAT. § 38-10-111 (West 2000).

<sup>258</sup> See Amy Lynn Wagenfeld, Note, *Law for Sale: Alaska and Delaware Compete for Asset Protection Market and the Wealth that Follows*, 32 VAND. J. TRANSNAT’L L. 831, 850 (1999).

<sup>259</sup> ALASKA STAT. § 34.40.110(a)-(b) (Michie 2000).

<sup>260</sup> DEL. CODE ANN. tit. 12, § 3570-3576 (Supp. 2000).

<sup>261</sup> NEV. REV. STAT. ANN. § 166.010 (Michie 1993).

<sup>262</sup> R.I. GEN. LAWS §§ 18-9.2 (2000).

<sup>263</sup> In addition to providing protection from creditors’ claims, such trusts are designed to provide wealth transfer tax planning benefits by allowing (i) transfers to such trusts to be completed gifts for federal gift

of a trust to transfer assets to the trust that will be protected from the claims of most of his or her creditors<sup>264</sup> even though he or she retains a beneficial interest in the trust and its assets. From a policy perspective, the wisdom of allowing such self-settled spendthrift trusts has been questioned by several commentators, as has the ability of such statutes to succeed in preventing creditors of the settlor from reaching the trust assets.<sup>265</sup> In rejecting the approach taken in Alaska, Delaware, Nevada, and Rhode Island, the U.T.C. drafters “concluded that it was undesirable as a matter of policy to allow a settlor to create a trust, retain a beneficial interest, but yet deny the settlor’s creditors the right to reach the trust.”<sup>266</sup>

Professor Boxx has categorized the policy objections to self-settled spendthrift trusts as moral and economic.<sup>267</sup> As to the former, “the moral argument is simple and intuitive: You should keep your promises and pay your debts because it is the right thing to do...[T]here is something disturbing about a country that would allow debtors to

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tax purposes and (ii) the assets in such trusts (including any appreciation in their value) to be excluded from the settlor’s taxable estate for federal estate tax purposes. *See* Douglas J. Blattmachr & Jonathan G. Blattmachr, *A New Direction in Estate Planning: North to Alaska*, TRUSTS & EST., Sept. 1997, at 48; Jeffrey T. Getty, *Federal Estate and Gift Tax Issues with Domestic Asset Protection Trusts*, (pts. 1 & 2) TR. & EST., June 2001, at 45, TRUSTS & EST. Sept. 2001, at 64.

<sup>264</sup> The Alaska statute does not bar the claims of claimants for back child support. ALASKA STAT. § 34.40.110(d) (Michie 2000). The Delaware and Rhode Island statutes allow the claims of spousal, as well as child support, claimants and claims arising out of torts that occurred before the trust was established. DEL. CODE ANN. tit. 12, § 3574 (Supp. 2000); R.I. GEN. LAWS § 18-9.2-5 (2000).

<sup>265</sup> *See* Karen E. Boxx, *Gray’s Ghost – A Conversation About the Onshore Trust*, 85 IOWA L. REV. 1195 (2000); Randall J. Gingiss, *Putting a Stop to “Asset Protection” Trusts*, 51 BAYLOR L. REV. 987 (1999); Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability*, 35 REAL PROP. PROB. & TRUST L.J. 479 (2000); Stewart E. Sterk, *Asset Protection Trusts: Trust Law’s Race to the Bottom*, 85 CORNELL L. REV. 1035, 1042 (2000). For a contrary view, *see* Hirsch, *supra* note \_\_\_\_.

<sup>266</sup> David M. English, *The Uniform Trust Code (2000) and Its Application to Ohio*, PROB. L.J. OF OHIO, Sept.-Oct. 2001, at 6 [hereinafter *Application to Ohio*].

<sup>267</sup> Boxx, *supra* note \_\_\_\_, at 1259-61.

leave their debts unpaid and still enjoy an extravagant lifestyle.”<sup>268</sup> With respect to the latter, Professor Boxx notes the warning of Professor LoPucki “that the increasing ability to avoid liability threatens the system of civil enforcement of obligations, both tort and contract.”<sup>269</sup> Other economic objections to allowing self-settled spendthrift trusts include their tendency to increase hazardous conduct by settlor/beneficiaries,<sup>270</sup> their negation of the limits of exempt property statutes,<sup>271</sup> the opportunity they provide settlor/beneficiaries to mislead voluntary creditors,<sup>272</sup> and the adverse effect they would have on the practices of creditors in setting terms for the extension of credit.<sup>273</sup> While state legislation authorizing self-settled spendthrift trusts may have short-term positive economic effects on the enacting state in attracting trust business, to the extent such trusts are effective, externalities will be borne by other states.<sup>274</sup> There is thus much to commend the U.T.C. drafters’ decision to reject self-settled spendthrift trusts.

## VII. U.T.C. Section 506: Overdue Distribution

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<sup>268</sup> *Id.* at 1259. While the protection from creditors’ claims afforded to beneficiaries of non self-settled spendthrift trusts allows such beneficiaries to enjoy the benefits trusts can provide without paying their creditors, there is a qualitative difference between providing that protection to a beneficiary of a trust created by another and providing it to a settlor/beneficiary. *See* Sterk, *supra* note \_\_\_\_, at 1044 (“although courts and legislatures have had some sympathy for property owners seeking to protect their imprudent or profligate children, the notion that property owners ought to be able to protect themselves against their own profligacy, at the expense of their creditors, has been much harder to swallow.”) *See also* Lischer, *supra* note \_\_\_\_, at 534-37. *But see* Hirsch, *supra* note \_\_\_\_, at 83-84.

<sup>269</sup> Boxx, *supra* note \_\_\_\_, at 1260 (citing Lynn M. Lopucki, *The Death of Liability*, 106 YALE L.J. 1 (1996)).

<sup>270</sup> *See* Lischer, *supra* note \_\_\_\_, at 542-43.

<sup>271</sup> *Id.* at 543-44.

<sup>272</sup> *Id.* at 545.

<sup>273</sup> *Id.* at 546.

<sup>274</sup> *See* Sterk, *supra* note \_\_\_\_, at 1072-74.

If a trust instrument requires a trustee to make a distribution to a beneficiary, but the trustee does not do so within a reasonable time after the distribution is required to be made, U.T.C. section 506, consistent with the Restatement,<sup>275</sup> allows a creditor of the beneficiary to reach the amount distributable even if the trust instrument includes a spendthrift provision.<sup>276</sup> This rule, which is applicable to required distributions of both income and principal,<sup>277</sup> is a compromise between the view that “a trustee should not be able to avoid creditor claims against a beneficiary by refusing to make a distribution required to be made by the express terms of the trust,”<sup>278</sup> and the fact that “a spendthrift provision would become largely a nullity were a beneficiary’s creditors able to attach all required payments as soon as they became due.”<sup>279</sup> The stated rationale for the rule of section 506 is that if the trustee continues to hold amounts required to be distributed to the beneficiary after a reasonable time for making the distribution, the distributable amounts “are in effect being held by the trustee as agent for the beneficiary and should be treated as part of the beneficiary’s personal assets.”<sup>280</sup>

The U.T.C. provides no guidance on the question of how long a trustee may reasonably hold funds distributable to a beneficiary/debtor before a creditor may attach

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<sup>275</sup> RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. d, at 425-26 (Tentative Draft No. 1, 1996).

<sup>276</sup> U.T.C. § 506.

<sup>277</sup> *Id.*

<sup>278</sup> *Id.* § 506 cmt.

<sup>279</sup> *Id.*

<sup>280</sup> *Id.* Two other rationales for the U.T.C.’s overdue distribution rule have been identified in the context of a beneficiary who is entitled to receive a distribution of income requesting the trustee to instead hold the amount distributable until the beneficiary requests its distribution:

The first is that as to the accumulated income the trust has become a dry or passive trust and becomes fully executed. The second theory is that by this conduct the beneficiary has unilaterally altered the terms of the trust and has therefore made himself the settlor of the accumulated income under his own revocable trust.



them. One commentator has noted that “[i]f the trust income is accumulated pending payment upon a regular payment date, most courts agree that the protection of the spendthrift provisions remains applicable.”<sup>281</sup> The Restatement overdue distribution rule focuses on how much time the trustee needs to make the required distribution; under it a distribution is overdue and thus reachable by a creditor of the beneficiary if it “is retained by the trustee beyond a time reasonably necessary to make distributions to the beneficiary,”<sup>282</sup> because at that time “the beneficiary has a right to demand immediate distribution.”<sup>283</sup>

### **VIII. U.T.C. Section 507: Personal Obligations of Trustee**

U.T.C. section 507 protects trust property from creditors to whom the trustee is personally obligated: “Trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt.”<sup>284</sup> The rationale for this well settled rule is that the trustee holds only legal title to trust property, the beneficial interest in which belongs to the beneficiaries of the trust and thus ought not be subject to claims of the trustee’s personal creditors.<sup>285</sup> Consistent with the basic rule of section 507, if a trustee’s personal creditor attaches trust property to satisfy the trustee’s personal

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BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 227, at 514-15.

<sup>281</sup> BOGERT, BOGERT & HESS, *supra* note \_\_\_\_, § 227, at 514-15.

<sup>282</sup> RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. d, at 425 (Tentative Draft No. 1, 1996).

<sup>283</sup> *Id.* at 425-26.

<sup>284</sup> U.T.C. § 507.

<sup>285</sup> U.T.C. § 507 cmt.

obligation, the creditor “does not acquire title as a bona fide purchaser even if the creditor is unaware of the trust.”<sup>286</sup>

## **IX. Creditors versus Trustees and Beneficiaries: The U.T.C.’s Compromise**

In assessing the compromise struck by the U.T.C.’s drafters between the rights of creditors of trust beneficiaries, on the one hand, and the rights of settlors<sup>287</sup> and beneficiary/debtors, on the other, it is useful to consider their relative positions both when the beneficiary is a settlor of the trust and when the beneficiary is not a settlor. With respect to the latter, the trust instrument may include one or both of the two most significant protective devices – making the trust spendthrift and making the beneficiary’s interest discretionary<sup>288</sup> – or it may not include either of them. Thus, the following discussion addresses issues with respect to the rights of creditors under the U.T.C. when the beneficiary is a settlor, and when the beneficiary is not a settlor and: (i) there is no spendthrift provision and the beneficiary’s interest is not discretionary; (ii) there is a spendthrift provision and the beneficiary’s interest is not discretionary; (iii)

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<sup>286</sup> *Id.*

<sup>287</sup> As discussed *supra* note \_\_\_\_\_ and accompanying text, a fundamental rationale for enforcing spendthrift provisions is that generally, property owners should be free to dispose of their property with such restrictions as they see fit to impose.

<sup>288</sup> Other trust protective devices include forfeiture provisions and provisions limiting the beneficiary’s interest to distributions for support. *See generally* 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, 695-99 (1994). In their pure form, forfeiture provisions, however, terminate the beneficiary’s interest if a creditor tries to reach it and thus are not commonly used. *Id.* at 699. As previously discussed, the U.T.C. does not distinguish between support and discretionary trusts, but instead treats trusts for the beneficiaries’ support as discretionary trusts with standards to guide the trustee in the exercise of its discretion. *See supra* note \_\_\_\_\_ and accompanying text. Thus, the protective devices to analyze in

there is no spendthrift provision and the beneficiary's interest is discretionary; and (iv) there is a spendthrift provision and the beneficiary's interest is discretionary.

**A. Beneficiary is a settlor.** With respect to trusts in which the settlor retains a beneficial interest,<sup>289</sup> the U.T.C.'s simple and straightforward rules clearly favor the settlor/beneficiary's creditors.<sup>290</sup> If the settlor can revoke the trust, all of its assets are subject to claims of the settlor's creditors both during the settlor's life and after the settlor's death.<sup>291</sup> If the trust is irrevocable, then without regard to whether the instrument includes a spendthrift provision, creditors "may reach the maximum amount that can be distributed to or for the settlor's benefit."<sup>292</sup> These rules are consistent with existing law in a significant majority of jurisdictions.<sup>293</sup> While the revocable trust rules are not controversial, the U.T.C. drafters' decision to reject self-settled irrevocable spendthrift trusts of the kind authorized by the recent legislation enacted in Alaska,

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evaluating the U.T.C.'s creditor's rights provisions are making the beneficiary's interest discretionary and including a spendthrift provision in the governing instrument.

<sup>289</sup> See the discussion of U.T.C. § 505 at *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>290</sup> A possible exception is the U.T.C.'s failure to include in section 505, or in the definition of "settlor" in section 103(16), rules designed to cover circumstances in which a property owner may be the settlor of a trust in substance, if not in form. *See supra* note \_\_\_\_\_. Arguably, the absence of such rules will allow such a property owner to avoid the creditor friendly rules mandated by section 505 by, for example, providing the consideration for a third party to create a trust in which the property owner has a beneficial interest. Such an attempt, however, likely would be unsuccessful because the U.T.C. provides that it is supplemented by "[t]he common law of trusts and principles of equity" . . . "except to the extent modified by this [Code] or another statute of this State." U.T.C. § 107. The application of the rules of section 505 to "settlors," and the relatively narrow definition of "settlor" in section 103(16), should not rise to the level of a modification of the common law of trusts and principles of equity with respect to indirect transfers to trusts by property owners. *See* RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. f, at 427-28 (Tentative Draft No. 1, 1996). For a discussion of a circumstance when section 107 likely will not be applicable to supplement rules set forth with some specificity under the U.T.C., see *supra* note \_\_\_\_\_ and accompanying text.

<sup>291</sup> U.T.C. § 505(a)(1), (3).

<sup>292</sup> U.T.C. § 505(a)(2).

<sup>293</sup> *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

Delaware, Rhode Island, and Nevada<sup>294</sup> is contrary to what might be characterized as a “trend.” For reasons that have been ably discussed by others,<sup>295</sup> the U.T.C. drafters’ decision not to follow any such trend was the right one.

**B. Beneficiary is not a settlor; no spendthrift provision; beneficiary’s interest is not discretionary.** A beneficiary’s creditors will have significant rights to reach the trust assets if the trust instrument does not include a spendthrift provision and the beneficiary’s interest is not discretionary, even if the beneficiary/debtor is not a settlor of the trust. For example, assume a third-party created trust under which the trustee is directed to distribute income to the beneficiary each year until the beneficiary reaches a specified age, at which time the trustee is directed to distribute the principal to the beneficiary. Under section 501, if the beneficiary’s interest is not protected by a spendthrift provision, “the court may authorize a creditor . . . of the beneficiary to reach the beneficiary’s interest, including by attachment of present or future distributions to or for the benefit of the beneficiary.”<sup>296</sup> Upon receiving service of such an attachment order, the trustee then would make distributions otherwise due to the beneficiary to the creditor.<sup>297</sup> Furthermore, the trustee can not avoid that result by simply failing to make required distributions, as under section 506, creditors may reach distributions a trustee is required to make to a debtor/beneficiary but does not distribute within a reasonable time.<sup>298</sup>

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<sup>294</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>295</sup> See authorities cited in note \_\_\_\_, *supra*, and the brief discussion of some of those reasons in *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>296</sup> U.T.C. § 501.

<sup>297</sup> U.T.C. § 501 cmt.

<sup>298</sup> U.T.C. § 506.

The comment to section 501 offers the following description of its effect:

“[a]bsent a valid spendthrift provision, the interest of a beneficiary may be reached the same as any other of the beneficiary’s assets.”<sup>299</sup> That summary description, however, overstates the strength of the position of a beneficiary’s creditors, as there are significant limitations on creditors’ access to a beneficiary’s interest even if the beneficiary is not a settlor of the trust and even if the trust instrument provides for mandatory distributions and does not include a spendthrift provision. Most important, while section 501 authorizes a court to allow a creditor to reach the beneficiary’s interest in a non-spendthrift trust, in doing so it may “limit the award to such relief as is appropriate under the circumstances.”<sup>300</sup> While this discretion presumably is to be exercised to preserve trust assets to provide for the basic support of the beneficiary and his or her family,<sup>301</sup> neither section 501 nor its comment includes any such express limitation. As noted by the U.T.C.’s reporter, the effect of the grant of discretion to the court to limit creditors’ ability to reach beneficiaries’ interests, even in non-spendthrift trusts, “is to make all trusts at least modestly spendthrift.”<sup>302</sup>

A second limitation on the ability of creditors of beneficiaries to reach their debtors’ interests in non-spendthrift trusts is that a sale of the interest may not,

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<sup>299</sup> U.T.C. § 501 cmt.

<sup>300</sup> U.T.C. § 501.

<sup>301</sup> See *supra* note \_\_\_\_\_ and accompanying text.

<sup>302</sup> David M. English, *Memorandum to Commissioners, Advisors, Observers, Drafting Committee on Uniform Trust Act* (Oct. 21, 1999) at <http://www.law.upenn.edu/bll/ulc/uta/trst1018.htm> [hereinafter *Memorandum to Commissioners*].

depending on the circumstances,<sup>303</sup> be permitted.<sup>304</sup> Thus, depending on the amount owed, the size of distributions due to the beneficiary, and the amounts, if any, the court orders be preserved for the beneficiary and his or her family, the creditor may be required to collect the debt from the trustee over a long period of time.<sup>305</sup>

**C. Beneficiary is not a settlor; instrument includes a spendthrift provision; beneficiary's interest is not discretionary.** If the beneficiary's right to distributions from a third-party created trust is not subject to the trustee's discretion, and the trust instrument includes a spendthrift provision, the most significant limits on the ability of the creditor to reach the beneficiary's interest will be those imposed by the spendthrift provision.<sup>306</sup> Under the U.T.C. a spendthrift provision will prevent a beneficiary's creditor from reaching the beneficiary's "interest or a distribution by the trustee before its receipt by the beneficiary."<sup>307</sup> As previously discussed,<sup>308</sup> the U.T.C. includes several exceptions to the protection spendthrift provisions afford. The most significant of those exceptions is that such a provision will not bar a claim by a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support

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<sup>303</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>304</sup> The comment to section 501 notes that a "creditor may also, *in theory*, be able to force a judicial sale of a beneficiary's interest." U.T.C. § 501 cmt. (emphasis added).

<sup>305</sup> Because the court's order allowing the creditor to reach the beneficiary's interest may apply to future as well as present distributions, U.T.C. § 501, it would appear that it should not be necessary for the creditor to pursue collection of its claim in periodic judicial proceedings. However, the court's authorization to limit the creditor's award "to such relief as is appropriate under the circumstances," *id.*, may dictate otherwise, as presumably either the creditor or the beneficiary may periodically petition the court to reconsider the creditor's award based on changed circumstances.

<sup>306</sup> For a discussion of limitations on a creditor's access to the beneficiary's interest even when the instrument does not include a spendthrift provision, see *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>307</sup> U.T.C. § 502(c).

<sup>308</sup> See *supra* note \_\_\_\_\_ and accompanying text.

or maintenance.<sup>309</sup> Although the debate among the drafting committee of whether to include that exception has been described as “intense,”<sup>310</sup> the vote to do so was unanimous.<sup>311</sup> The Reporter’s explanation of the committee’s decision is as follows:

Both Restatements and many states’ statutes, as well as other relevant statutes such as Federal Bankruptcy Code § 523(a)(5) and ERISA § 206(d)(3), grant special deference to the enforcement of court orders for support or maintenance of the beneficiary’s child, current spouse and former spouse. Given this background and the important public policy concerns in making certain that those to whom legal obligations of support are owed actually receive such support, the Act provides that a beneficiary’s child, current spouse or former spouse who has a judgment against the beneficiary for support or maintenance may obtain against the trust, in an appropriate judicial proceeding, an order attaching present or future distributions to or for the benefit of the beneficiary.<sup>312</sup>

Thus, the U.T.C. provides substantial protection to a child, spouse, or former spouse, who has a judgment or court order for support against a beneficiary of a spendthrift trust in which the beneficiary’s interest is not discretionary.<sup>313</sup>

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<sup>309</sup> U.T.C. § 504(b)(2). The other spendthrift exceptions under the U.T.C. are for judgment creditors who have provided services to protect the beneficiary’s interest in the trust, U.T.C. § 503(a), and for claims of the state or the United States under state statutes or federal law that provide that the government claims are not barred by a spendthrift provision. U.T.C. § 503(b).

<sup>310</sup> See Young, *supra* note \_\_\_\_\_, at 109.

<sup>311</sup> *Id.* Apparently there was no similar unanimity among estate and trust practitioners who were consulted on the question of whether such an exception should be included; their support was said to be “stronger with respect to children, less strong for present spouses, and negative for former spouses.” *Id.* at 109-10. For a case discussing, but rejecting, the approach of allowing child support claims, but not alimony claims, to override a spendthrift provision, see *Shelley v. Shelley*, 354 P.2d 282 (Or. 1960).

<sup>312</sup> English, *Uniform Trust Act in Your Future*, *supra* note \_\_\_\_\_, at 31.

<sup>313</sup> As discussed *infra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text, protection also is afforded to such creditors when the beneficiary’s interest is discretionary, but in those cases, the protected creditors will have additional hurdles to overcome to reach the beneficiary’s interest. And even when the beneficiary’s interest is not discretionary, there are limits on the protection afforded to a beneficiary’s child, spouse, or former spouse by the spendthrift exception. For example, the U.T.C. gives the court discretion to limit the award of the child, spouse, or former spouse to preserve funds for the beneficiary’s needs. See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. Further, if the beneficiary’s non-discretionary entitlement is to receive distributions of trust income, the amount of income that will be available to the protected creditors depends not only on the exercise of the court’s discretion to preserve funds for the beneficiary’s needs, but

Tort creditors of spendthrift beneficiaries are not similarly protected by the U.T.C. The spendthrift bar of section 502(c) applies “except as otherwise provided in this [article],”<sup>314</sup> and there is no exception in Article V for tort claims.<sup>315</sup> Thus, creditors asserting such claims may not reach the beneficiary’s interest in a spendthrift trust regardless of (i) the nature of the beneficiary’s conduct,<sup>316</sup> (ii) the beneficiary’s and the creditor’s needs,<sup>317</sup> and (iii) the size of the trust.

A fundamental justification for enforcing spendthrift provisions generally, and thus enforcing them against the claims of a beneficiary’s tort creditors, is that a settlor who makes a gift of property in trust may condition or limit the gift as he or she sees fit.<sup>318</sup> Under this rationale, the interests of the beneficiary are of little, if any, consequence; rather, enforcing spendthrift trusts respects the property rights of trust

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also on whether the trustee pursues investment policies that result in significant amounts of income or in expected growth of principal with little or no current income.

<sup>314</sup> U.T.C. § 502(c).

<sup>315</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>316</sup> Two recent cases illustrate the kinds of tort claims that will be barred by the U.T.C.’s spendthrift bar. In *Sligh v. First National Bank of Holmes County*, 704 So.2d 1020 (Miss. 1997), an uninsured spendthrift trust beneficiary, while driving under the influence of alcohol, caused an accident in which the plaintiff was paralyzed with a broken spine. For a discussion of *Sligh*, see *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. In *Scheffel v. Krueger*, No. 99-619, 2001 WL 839850 (N.H. July 26, 2001), the claim against the beneficiary’s interest in the spendthrift trust was based on allegations that he sexually assaulted a minor child. See *supra* note \_\_\_\_\_ and accompanying text.

<sup>317</sup> If tort claimants were allowed to reach the tortfeasor’s beneficial interest in a spendthrift trust, the court with the authority to allow the creditor to do so could be given the same discretion to consider the beneficiary’s needs as it is given when the creditor is a child, spouse, or former spouse of the beneficiary. See U.T.C. § 501.

<sup>318</sup> See, e.g., *In re Morgan’s Estate*, 72 A. 498 (Pa. 1909) (“When a [spendthrift] trust . . . has been created, the law holds that the donor has an individual right of property in the execution of the trust; and to deprive him of it would be a fraud on his generosity.”).



settlor.<sup>319</sup> When the battle over the validity of spendthrift trusts was fought, however, the protection a trust settlor could provide the beneficiaries by including a spendthrift provision in the instrument was limited in duration by the Rule Against Perpetuities. In many jurisdictions, no such limitation now exists.<sup>320</sup> As a result, trusts designed to last forever, in part to provide asset protection to beneficiaries, are becoming increasingly popular.<sup>321</sup> In turn, the new phenomenon of perpetual trusts has led to a relaxation of the formerly stringent rules limiting the ability of beneficiaries to modify or terminate trusts.<sup>322</sup> The control of such trusts, and thus the assets in them, by their beneficiaries also is being accomplished more directly by naming the beneficiary as trustee, or co-trustee, of the trust, and providing him or her with a special power of appointment to control the ultimate disposition of the trust assets.<sup>323</sup> In this new environment, the question of whether tort creditors of a spendthrift trust beneficiary/tortfeasor should be barred from reaching the beneficiary's interest in a trust over which he or she may have been given substantial control, without regard to the nature of the beneficiary's conduct,

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<sup>319</sup> "It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law; it has regard solely to the rights of the donor." *Id.* Similarly, as noted by Professor Sterk:

The rationale for enforcing spendthrift trusts has been that the trust property belongs not to the trust beneficiary, but to the trust settlor. Because the settlor has no obligation to transfer the property to the beneficiary, the settlor is entitled to transfer it to the beneficiary subject to conditions, including the condition that the property be shielded from the beneficiary's creditors.

Sterk, *supra* note \_\_\_\_\_, at 1042.

<sup>320</sup> See Ira Mark Bloom, *The GST Tax Tail Is Killing The Rule Against Perpetuities*, 87 TAX NOTES 569, 571-72 (2000) (listing as such jurisdictions Alaska, Delaware, Idaho, Illinois, Maine, Maryland, New Jersey, Ohio, Rhode Island, South Dakota, and Wisconsin). Since Professor Bloom's article was published, Florida has adopted a 360-year Rule Against Perpetuities period, FLA. STAT. ANN. § 689.225 (West Supp. 2001), and Virginia has enacted legislation sanctioning perpetual trusts, Va. Code Ann. § 55-13.3 (Michie Supp. 2000). See generally Joel C. Dobris, *The Death of the Rule Against Perpetuities, or the RAP Has No Friends—An Essay*, 35 REAL PROP. PROB. & TRUSTS J. 601 (2000).

<sup>321</sup> See Oshins & Oshins, *supra* note \_\_\_\_\_.

<sup>322</sup> See Ronald Chester, *Modification and Termination of Trusts in the 21st Century: The Uniform Trust Code Leads a Quiet Revolution*, 35 REAL PROP. PROB. & TRUSTS J. 697 (2000).

in deference to the property rights of a settlor who may have died decades or perhaps even centuries earlier, deserves reconsideration. At least when the beneficiary's tortious conduct is intentional, reckless, or grossly negligent, those injured by such conduct ought to be able to reach at least a part of trust assets available for distribution to or for the benefit of the beneficiary without regard to whether the trust instrument includes a spendthrift provision.

More generally, enforcing spendthrift provisions is sometimes said to be of little significance, because such provisions offer trust beneficiaries only limited protection from their creditors.<sup>324</sup> The basis for that view is that the effect of a valid spendthrift provision is only to prevent the barred creditor from reaching trust assets prior to their distribution to the beneficiary;<sup>325</sup> once in the hands of the beneficiary, the distributed assets are subject to creditors' claims.<sup>326</sup> As a practical matter, however, the protection an enforceable spendthrift provision affords can completely foreclose a beneficiary's creditor from reaching trust assets while preserving them for the beneficiary's use. For example, the beneficiary may spend all of a distribution before the creditor is able to reach it. Of more significance, the trustee may make most or all distributions to third parties for the beneficiary's benefit, rather than directly to the beneficiary,<sup>327</sup> in which

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<sup>323</sup> See Oshins & Oshins, *supra* note \_\_\_\_.

<sup>324</sup> See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 58 rep. notes on § 58 cmt. a, at 433 (Tentative Draft No. 1, 1996) (characterizing the protection afforded by a spendthrift provision as "distinctly limited.").

<sup>325</sup> U.T.C. § 502(c).

<sup>326</sup> "[A] spendthrift provision provides only limited protection to the beneficiary. The creditor...may pounce upon the trust funds as soon as distribution is made." David M. English, *The Need to Codify the Law of Trusts: The Experience from the Uniform Trust Act 14* (2000) (unpublished paper, Annual Meeting of the Donative Transfers Section of the American Association of Law Schools) (on file with author) [hereinafter *Need to Codify*].

<sup>327</sup> See *supra* note \_\_\_\_ and accompanying text.

case the beneficiary may have few if any assets the creditor can reach. If the jurisdiction protects a person's homestead from creditors' claims,<sup>328</sup> the beneficiary could own his or her home, with mortgage payments and the costs of insurance, taxes, maintenance, improvements, and utilities paid by the trustee. To preclude creditors from reaching the beneficiary's residence upon the beneficiary's death (or if the beneficiary is a true spendthrift and there is a concern that he or she will mortgage the residence), the trust could simply own it and provide its use to the beneficiary.

Similarly, the beneficiary could lease an automobile, the payments for which could be made by the trustee. Further, much of what people need or want, including cash, can be charged to a credit card, the monthly bill for which could be submitted to the trustee for payment. Bills for expenses that cannot be paid for by credit card also could be submitted to the trustee. In addition, the beneficiary could be given a bank debit card for a trust account. Although none of these means would allow a beneficiary to accumulate substantial assets that he or she owns, that fact may be of little significance to a beneficiary whose needs and wants are being met by the trust assets, who may serve as sole or co-trustee of the trust, and who, through a special power of appointment, may be given the ability to direct the disposition of the trust assets to others during the beneficiary's life or at his or her death.<sup>329</sup> In short, a spendthrift trust

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<sup>328</sup> See generally Henkel, *supra* note \_\_\_\_, at ¶ 53.10[3][a].

<sup>329</sup> Such a beneficiary controlled trust has been described as follows:

It is a trust where the primary beneficiary either is the sole trustee or has the ability to fire any co-trustee and select a successor co-trustee. Typically, control of the trusteeship is coupled with a power of appointment that can have the effect of eliminating any potential interference by remote beneficiaries. Because the primary beneficiary/trustee possesses the ability to eliminate all participation in the enjoyment of the trust assets by secondary and remote beneficiaries, the latter will not be inclined to bring a lawsuit because their rights

may insulate assets from most creditors of a beneficiary even though the beneficiary has similar control and access over the trust assets as the beneficiary would have if he or she owned them outright.<sup>330</sup> Thus, spendthrift provisions provide trust settlors with a powerful means of securing assets and income for the benefit of trust beneficiaries free from the claims of most of their creditors.

**D. Beneficiary is not a settlor; instrument does not include a spendthrift provision; beneficiary's interest is discretionary.** If the instrument of a third-party created trust does not include a valid spendthrift provision, the U.T.C. allows a creditor of the beneficiary to reach not only required distributions to the beneficiary, but also required distributions made for the benefit of the beneficiary and distributions the trustee, in the exercise of its discretion, decides to make.<sup>331</sup> Unless the creditor is a child, spouse, or former spouse with a judgment or court order for support or maintenance,

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could be eliminated.

Oshins & Oshins, *supra* note \_\_\_\_\_, at 61 (footnote omitted).

<sup>330</sup> In at least one circumstance a beneficiary's creditor who is not the beneficiary's child, spouse, or former spouse may be able to reach spendthrift trust assets despite the ability of the trustee to make distributions to third parties for the beneficiary's benefit instead of directly to the beneficiary. In the unlikely event that required distributions are in excess of what the beneficiary wants or needs to spend, the trustee will not be able to withhold part of the distributable amounts and protect that part from creditors' claims. U.T.C. § 506. However, if the excess required distributions would result from the trustee being required to distribute all or a fixed part of the trust's income to the beneficiary, perhaps they could be avoided by the trustee investing the trust assets so as to earn no more income for the beneficiary than he or she wants or needs to spend. If, however, the amount distributable to the beneficiary is a fixed amount, or a fixed percentage of the value of the trust estate, and the distributable amount exceeds what the beneficiary can spend, his or her creditors will be able to reach the excess.

<sup>331</sup> U.T.C. § 501. As discussed *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text, the creditor's award may be limited to preserve funds for the beneficiary's needs. The provision in section 501 allowing creditors to reach not only distributions the trustee of a non-spendthrift trust decides to make to the beneficiary, but also distributions the trustee makes by paying third parties for the beneficiary's benefit, is consistent with the Restatement: "section [60] prevents the trustee not only from making payments to the beneficiary but also from making 'distributions' by applying funds directly for the beneficiary's benefit. . . ." RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. a, at 483 (Tentative Draft No. 2, 1999). *See also id.* cmt. c, at 486 ("If the trustee has been served with process in a proceeding by a creditor to reach the beneficiary's interest, the trustee is personally liable to the creditor for any amount paid to or applied for the benefit of

however, the creditor may not compel a distribution even if the trustee has abused its discretion or failed to comply with a standard of distribution.<sup>332</sup> Furthermore, an award allowing such an ordinary creditor to attach present or future distributions the trustee decides to make to or for the beneficiary's benefit is subject to limitation by the court, presumably so that the trustee may provide for the basic support needs of the beneficiary and his or her dependents.<sup>333</sup>

In a given case, the effect of these rules could be that neither the beneficiary (except to the extent of amounts reserved to provide for the needs of the beneficiary and his or her dependents) nor the creditor would receive any benefit from the trust, because the creditor (who is not a child, spouse, or former spouse with a judgment or court order for support from the beneficiary) could not compel a distribution and the trustee would not exercise its discretion to make distributions that would have to be paid to the creditor. Depending on such factors as the size of the trust estate, the relative interests of the debtor and other beneficiaries in the trust, the size of the creditor's claim, and the amounts, if any, the court determines are distributable for the needs of the beneficiary

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the beneficiary in disregard of the rights of the creditor, in the absence of a valid spendthrift provision...applicable to the creditor...").

<sup>332</sup> U.T.C. § 504(b). By contrast, under the Restatement any creditor of the beneficiary may be able to compel a distribution by arguing that the failure of the trustee to make it was an abuse of discretion. RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e, at 490 (Tentative Draft No. 2, 1999). However, 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...the balancing process typical of discretionary issues becomes, in this context, significantly weighted against creditors....

*Id.* at 489.

<sup>333</sup> See U.T.C. § 501, discussed *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text. Note that under section 501, the question of whether a beneficiary of a non-spendthrift, discretionary trust could receive distributions for his or her basic needs and those of his or her family, without any distributions being made for the creditor to reach, apparently is left to the court's discretion. Such a result is contemplated by the

and his or her dependents, such a stalemate might lead to a settlement.<sup>334</sup> Particularly if the court authorizes distributions for the support needs of the beneficiary and his or her dependents that the creditor cannot reach, and given the possibility that the beneficiary will have access to funds from other sources, such as family members, the beneficiary likely would be in a substantially better position than the creditor in negotiating such a settlement.

If the creditor of a beneficiary of a non-spendthrift, discretionary trust is a child, spouse, or former spouse of the beneficiary with a judgment or court order against the beneficiary for support or maintenance, the creditor may be able to compel a distribution, part or all of which would be payable to the creditor.<sup>335</sup> To do so, however, the creditor must show that the “trustee has not complied with a standard of distribution or has abused a discretion.”<sup>336</sup> As previously discussed, a creditor may be able to make the required showing if the trustee has the discretion to make distributions for the beneficiary/debtor’s support, but may be unable to do so if there is no stated standard, or if a non-support standard is to govern the trustee’s exercise of its discretion.<sup>337</sup> Given the U.T.C.’s acknowledgment of the strong policy in favor of the support claims of children,

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Restatement. *See* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e, illus. 5, at 489 (Tentative Draft No. 2, 1999).

<sup>334</sup> *See* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e, at 490 (Tentative Draft No. 2, 1999) (“[I]n many cases a trustee might properly make distributions pursuant to an arrangement with the attaching creditor(s) that would serve the beneficiary’s interests in a manner consistent with the trustee’s duty of impartiality, the terms of the discretionary power, and the more general purposes of the settlor.”).

<sup>335</sup> U.T.C. § 504(c).

<sup>336</sup> *Id.* In addition, the amount the creditor could compel the trustee to pay to the creditor would be limited to the amount that 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.” U.T.C. § 504(c)(2).

<sup>337</sup> *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

spouses, and former spouses of trust beneficiaries,<sup>338</sup> requiring such a creditor to prove that a trustee who decides not to make discretionary distributions to the beneficiary/debtor has abused its discretion is difficult to justify. An approach more consistent with the U.T.C.'s recognition of the important policy considerations in favor of children, spouses, and former spouses whom the beneficiary is obligated to support would be to allow the support creditor to reach the amount the trustee could have distributed to or for the beneficiary's benefit in the proper exercise of its discretion.<sup>339</sup>

**E. Beneficiary is not a settlor; instrument includes a spendthrift provision; beneficiary's interest is discretionary.** A settlor of a trust governed by the U.T.C. who wants to protect trust assets from beneficiaries' creditors to the maximum extent possible will include a spendthrift provision in the governing instrument, provide that all distributions for the beneficiaries are at the trustee's discretion, and authorize the trustee to make distributions for the beneficiaries' benefit to third parties as well as directly to the beneficiaries. Furthermore, to minimize or eliminate the risk that a beneficiary's interest in the trust will be an available resource that will disqualify the beneficiary from receiving government assistance,<sup>340</sup> as well as the risk that the beneficiary's spouse, former spouse, or children will be able to compel distributions that they can reach,<sup>341</sup> the

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<sup>338</sup> See U.T.C. §§ 503(b), 504(b). See also *supra* note \_\_\_\_\_ and accompanying text.

<sup>339</sup> The difference between allowing support creditors to reach what the trustee properly could distribute to or for the beneficiary and allowing such creditors to reach only amounts that the trustee must distribute to avoid abusing its discretion is substantial. For a discussion of the respect courts afford decisions by trustees of discretionary trusts, see generally RESTATEMENT (THIRD) OF TRUSTS § 50 (Tentative Draft No. 2, 1999). Note also that this suggested change would not affect the ability of the court to limit a creditor's award to preserve the trustee's ability to provide for the beneficiary's needs. See *supra* note \_\_\_\_\_ and accompanying text.

<sup>340</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>341</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

settlor will not include a support standard<sup>342</sup> to guide the trustee's exercise of its discretion. Finally, the settlor will not name the beneficiary as trustee.<sup>343</sup>

If a trust is so structured, its spendthrift provision will prevent creditors of the beneficiary from reaching his or her interest or distributions for his or her benefit before their receipt by the beneficiary,<sup>344</sup> unless the creditor is (i) "a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance,"<sup>345</sup> (ii) "a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust,"<sup>346</sup> or (iii) a state or the United States, whose claim is not barred by the spendthrift provision due to a statute of the state or federal law.<sup>347</sup> The trustee and beneficiary may keep the trust assets, including those used for the beneficiary's benefit, out of the reach of all other creditors of the beneficiary (including government assistance providers and others who have provided necessities to the beneficiary<sup>348</sup> and claimants who are victims of even intentional, reckless, or grossly negligent tortious conduct by the beneficiary<sup>349</sup>) by having the trustee make "distributions" to the beneficiary by paying third parties directly for benefits provided to the beneficiary.<sup>350</sup> Furthermore, because of the discretionary nature of the beneficiary's interest, the trustee could prevent a judgment creditor who provided

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<sup>342</sup> For a list of standards that may be deemed to include the beneficiary's support, see *supra* notes \_\_\_\_\_ and \_\_\_\_\_.

<sup>343</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>344</sup> U.T.C. § 502(c).

<sup>345</sup> U.T.C. § 503(a).

<sup>346</sup> *Id.*

<sup>347</sup> U.T.C. § 503(b).

<sup>348</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_, \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>349</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>350</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.



services to protect the beneficiary's interest in the trust (whose claim would not be barred by the spendthrift provision<sup>351</sup>) from reaching any of the trust's assets by not exercising its discretion to make distributions to or for the benefit of the beneficiary.<sup>352</sup>

Moreover, if any creditor succeeds in attaching any discretionary (or mandatory, for that matter) distributions the trustee makes in the future to or for the beneficiary's benefit, its award may be limited by the court allowing some distributions to provide for the basic needs of the beneficiary and his or her dependents.<sup>353</sup> In addition, a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance and who is thus not subject to the spendthrift bar, and who may seek to compel the trustee to exercise its discretion to make distributions he, she, or they may reach, will be successful only if the creditor can show that the trustee's failure to make the requested distributions constituted an abuse of discretion.<sup>354</sup> Clearly, the rights of a creditor of a beneficiary of a spendthrift, discretionary trust that does not include a support standard, and that authorizes the trustee to make distributions by paying third parties directly for benefits provided to the beneficiary, are severely limited.

## **X. Conclusion**

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<sup>351</sup> U.T.C. § 503(b).

<sup>352</sup> Such creditors, as well as all others (except a child, spouse, or former spouse with a judgment or court order for support or maintenance), are foreclosed from asserting that the trustee's failure to exercise its discretionary power to distribute constituted an abuse of discretion. U.T.C. § 504(a).

<sup>353</sup> *See supra* notes \_\_\_\_\_ and \_\_\_\_\_ and accompanying text.

<sup>354</sup> *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

The most significant concession to creditors' rights made by the U.T.C. provides some protection to a creditor of a trust beneficiary who is the beneficiary's child, spouse, or former spouse and who has a judgment or court order for support or maintenance. A spendthrift provision will not bar such a creditor's claim against the beneficiary's interest,<sup>355</sup> and if the beneficiary's interest is discretionary, such a creditor may pursue an action to compel distributions that he, she, or they may reach.<sup>356</sup> To prevail in such an action, however, the creditor must show that the trustee's failure to make distributions constituted an abuse of its discretion.<sup>357</sup> If the trustee's discretion is not subject to a support standard, such a showing may be difficult, if not impossible, for a creditor to make.<sup>358</sup>

But because the support claims of a beneficiary's child, spouse, or former spouse are not barred by a spendthrift provision,<sup>359</sup> in many cases even such creditors who can not show the trustee's failure to make discretionary distributions was an abuse of discretion might, as a practical matter, be able to receive payments from the trust. Such creditors might not be able to compel distributions they could reach, but they could attach the beneficiary's interest, including present and future distributions the trustee decides to make to or for the benefit of the beneficiary.<sup>360</sup> Although the court could limit the creditor's award to preserve the trustee's ability to provide for the beneficiary's basic

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<sup>355</sup> U.T.C. § 503(a).

<sup>356</sup> U.T.C. § 504(b)(1).

<sup>357</sup> *Id.*

<sup>358</sup> *See supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>359</sup> U.T.C. § 503(a).

<sup>360</sup> U.T.C. § 501.

needs,<sup>361</sup> it is doubtful a court would authorize distributions for a beneficiary's needs without also requiring distributions to satisfy, or at least partially satisfy, the beneficiary's support obligations to his or her children, spouse, or former spouse.<sup>362</sup> Furthermore, no additional distributions could be made to or for the beneficiary's benefit without first satisfying any support claims of the beneficiary's child, spouse, or former spouse.<sup>363</sup> Thus, unless the beneficiary of a spendthrift, discretionary trust that does not include a support standard is willing to forego all distributions from the trust, his or her support creditors likely will be able to have part, if not all, of their claims satisfied. To provide protection to such creditors in cases in which the beneficiary is willing and able to forego all distributions from the trust, and in recognition of the strong policies in favor of support claimants, a state considering adoption of the U.T.C. should modify section 504(b) to allow a beneficiary's support creditors to reach the maximum amount the trustee could, in the proper exercise of its discretion, distribute to the beneficiary, rather than allowing the support creditor to reach only such amounts it can show the trustee was required to distribute to avoid an abuse of discretion.

Consistent with the law in all but a handful of states, the U.T.C. takes the pro-creditor position of allowing creditors of a settlor/beneficiary of a trust to reach all of the assets in the trust, if it is revocable,<sup>364</sup> or the maximum amount the trustee may distribute to the settlor/beneficiary, if it is irrevocable.<sup>365</sup> Less significant pro-creditor provisions of the U.T.C. include the requirement that the instrument include a

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<sup>361</sup> See *supra* note \_\_\_\_\_ and accompanying text.

<sup>362</sup> See *supra* note \_\_\_\_\_ and accompanying text.

<sup>363</sup> See U.T.C. § 501.

spendthrift provision for it to be treated as such;<sup>366</sup> the provision allowing creditors whose claims are not barred by a spendthrift provision to obtain an order attaching future as well as present distributions;<sup>367</sup> and the provision allowing creditors to reach overdue distributions from spendthrift trusts.<sup>368</sup>

Most of the U.T.C.'s other provisions on creditor's claims favor the beneficiary. First, consistent with the law in most states, spendthrift provisions generally are valid and effective under the U.T.C. without regard to the size of the trust, the needs of the beneficiary and his or her dependents, or the circumstances of the beneficiary's creditor.<sup>369</sup> Second, even if the instrument does not include a spendthrift provision, or if it includes one but the creditor's claim is not subject to it, the court is granted the discretion to limit the creditor's award, presumably to preserve the trustee's ability to provide for the needs of the beneficiary and his or her dependents.<sup>370</sup> Third, the spendthrift bar applies to those who provide necessities to the beneficiary.<sup>371</sup> Fourth, it also appears to provide absolute protection from the claims of a beneficiary's tort claimants, even if the beneficiary's liability arose out of intentional, reckless, or grossly negligent conduct.<sup>372</sup> Fifth, except for a beneficiary's child, spouse, or former spouse with a judgment or court order for support or maintenance, a creditor may not compel distributions from a discretionary trust even if the trustee's failure to make such

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<sup>364</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>365</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

<sup>366</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text

<sup>367</sup> U.T.C. § 501.

<sup>368</sup> U.T.C. § 506.

<sup>369</sup> U.T.C. § 502(c).

<sup>370</sup> See *supra* note \_\_\_\_\_ and accompanying text.

<sup>371</sup> See *supra* notes \_\_\_\_\_ - \_\_\_\_\_ and accompanying text.

distributions could be shown to be unreasonable, arbitrary, or intended to defeat claims of the beneficiary's creditors.

That the U.T.C.'s compromise of the creditor's rights issues favors trust settlors and beneficiaries over creditors of beneficiaries is evident from a comparison of the rights of beneficiaries' creditors under the U.T.C. with their rights under the Restatement. In a variety of contexts, the Restatement provides more protection to those asserting claims against beneficiaries' interests than such claimants have under the U.T.C. For example, under the U.T.C., a spendthrift provision bars a creditor whose claim against the beneficiary arose in tort,<sup>373</sup> was for necessary goods or services furnished to the beneficiary,<sup>374</sup> or was for a set-off against the beneficiary's interest in the trust.<sup>375</sup> By contrast, under the Restatement a spendthrift provision will not bar any of those claims.<sup>376</sup> Similarly, the Restatement, unlike the U.T.C.,<sup>377</sup> does not limit creditors who may compel distributions from discretionary trusts for a debtor/beneficiary to children, spouses, and former spouses who have judgments or court orders for support.<sup>378</sup>

States considering adoption of the U.T.C. should modify its creditors' rights provisions in two respects before doing so. First, a beneficiary's child, spouse, or former spouse with a judgment or court order for support ought to be able to compel

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<sup>372</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>373</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>374</sup> See *supra* notes \_\_\_\_ - \_\_\_\_ and accompanying text.

<sup>375</sup> See *supra* note \_\_\_\_ and accompanying text.

<sup>376</sup> RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a, & § 59(b) (Tentative Draft No. 2, 1999).

<sup>377</sup> U.T.C. § 504(c).

distributions he, she, or they can reach without having to establish that in not making the distribution, the trustee abused its discretion or failed to comply with a standard for distribution. Rather, such a creditor should be able to reach the maximum amount the trustee could distribute to or for the benefit of the beneficiary in the proper exercise of its discretion. Second, particularly given (i) the extent of control a beneficiary can be given over a third-party created trust, (ii) the fact that in a growing number of states trusts can exist in perpetuity, and (iii) the relaxation of the rules on the modification and early termination of trusts, the interest of a beneficiary whose conduct is not only tortious, but also grossly negligent, reckless, or intentional ought not be insulated from tort creditors' claims by a spendthrift provision. Rather, such creditors ought to be able to reach at least a portion of distributions made to or for the benefit of the beneficiary.

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<sup>378</sup> RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e (Tentative Draft No. 2, 1999).