

Effect of the UTC on the Asset Protection of Spendthrift Trusts

The new Uniform Trust Code will reduce substantially the asset protection of non-self-settled trusts from creditors. This first part of a three-part article analyzes the traditional creditor protection of discretionary trusts versus support trusts.

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With the spiraling divorce rate of over 50% in the U.S., as well as the increasing number of lawsuits, creditor protection is often the most important objective of our clients. An irrevocable trust established by someone other than a beneficiary provides the ultimate in creditor protection. As the asset protection maxim goes—"If you don't own it, nobody can take it away from you."¹ Historically, the general rule has been that the creator of the trust can dictate who may receive the beneficial enjoyment of the property and the extent and circumstances under which this enjoyment may be

obtained. As a result, unless trust property is distributed to a beneficiary, it will generally be protected from the beneficiary's creditors.

Unfortunately, the Uniform Trust Code ("UTC") may have significantly weakened the asset protection that was formerly available for discretionary trusts in states that have adopted it. Because of the issues surrounding the UTC, planners should consider moving all trusts and the underlying liquid assets intended to be creditor-protected out of UTC states.

The general rule is that, through accepted legal remedies, a creditor of a debtor stands in the shoes of the debtor and may exercise any property or other right that the debtor may exercise. So does this mean that a creditor may attach a beneficiary's trust interest or force the trust to make a distribution to the creditor in satisfaction of a beneficiary's debt? Further, could a creditor impose a lien on, or attach, a remainder interest? If this is the general rule, does an estranged spouse have more rights to attach a beneficial interest under

domestic relations law than an ordinary creditor has? Does a discretionary trust provide stronger creditor protection than a support trust? This article will answer these questions and others.

Creditor remedies prior to the UTC

To the extent that a trust beneficiary has a "property right," certain "exception creditors" may attach the beneficiary's interest. These "exception creditors" are generally the following exception creditors specifically listed in the Restatement (Second) of Trusts ("Restatement Second"):

1. Alimony and child support;
2. Necessary expenses of a beneficiary (i.e., governmental claims for medical expenses); and
3. Governmental claims.²

There is a fourth exception creditor listed in the Restatement Second—a creditor for expenses incurred to preserve a beneficial interest (i.e., attorney's fees).³ But most states have not adopted this fourth exception creditor.

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Exception creditors are allowed to attach the beneficial interest of a trust pursuant to the distribution standard in the support trust (e.g., health, education, maintenance and support).⁴ Because the beneficiary has a right to force a distribution pursuant to the distribution standard, the exception creditor also succeeds to such a right. In this respect, the exception creditor is able to reach part or all of the assets necessary to satisfy the creditor's claim directly from the trust property.

Current distribution analysis— Non-UTC state

In general, a current distribution interest is an interest whereby the trustee may make a mandatory distribution, a discretionary distribution, or a distribution based on a support standard. Generally, if the beneficiary does not have a property interest (i.e., an enforceable right⁵), a creditor has absolutely no right of recovery. The theory is that if the beneficiary does not have a right of recovery that he may enforce, the creditor can obtain no more rights than the beneficiary has over the trust assets. This rule that prevents recovery by a creditor is not dependent on spendthrift provisions. Rather, a creditor cannot compel the trustee to pay anything because the beneficiary cannot compel a payment.⁶ Therefore, so long as the governing law of the trust is not that of a state that has adopted the UTC, absent control issues, or, in a few states, certain divorce issues, if a beneficiary has no property interest, the analysis is generally concluded and the creditor has no right of recovery.

Not all state courts use a direct property analysis in determining whether a creditor may reach a beneficial interest. Instead, some

courts examine whether the beneficiary's interest has an ascertainable value.⁷ In essence, the analysis is the same. If the beneficiary's interest has no value, there is no interest or enforceable right that a creditor may attach.

On the other hand, if the beneficiary has a property interest, the trust must be reviewed to determine whether it contains a spendthrift clause. Almost all trusts have such a clause. A spendthrift clause generally protects a beneficiary's interest from attachment by a creditor. However, under the Restatement Second, there are four types of exception creditors (listed above) that may attach a beneficiary's interest regardless of the spendthrift provisions.

In addition, even if a creditor is not an exception creditor, or even if the trust is a discretionary trust, if the beneficiary holds too much control over the trust, a creditor will still be able to attach the beneficiary's interest and reach the trust assets. For example, if the beneficiary is the sole trustee and sole beneficiary of a trust, the trust assets may be available to a creditor.⁸

With respect to alimony and child support claims, a former spouse and minor children are exception creditors, and the former spouse may attach a current beneficial interest of a support trust on behalf of minor children. However, except for states that have adopted the UTC or the Restatement (Third) of Trusts ("Restatement Third"), any creditor, including an estranged spouse, generally does not have any claim against a discretionary trust.

A flowchart for non-UTC states for creditor recovery of a current beneficial interest, including recovery by an estranged spouse, appears in Exhibit 1.

Remainder interest analysis— Non-UTC state

The remainder interest analysis varies from the current distribution analysis in a few key areas. First, similar to a current beneficial interest, one must first determine whether the interest is a property interest. However, the Restatement Second adopts a different approach from what is used in the current beneficial interest analysis. If an interest is created for a group of persons, it is inseparable and a creditor cannot reach it.⁹ For example, a dynasty trust is a trust in which an interest never vests in anyone. Hence, an interest in a dynasty trust would not be a property interest and would be "inseparable" as defined in the Restatement Second.

The Restatement Second also provides that if an interest in a trust "is so indefinite or contingent that it cannot be sold with fairness to both the creditors and the beneficiary, it cannot be reached by his creditors."¹⁰ If this is the case, a creditor should not be able to recover from the trust. If this is not the

¹ Rosen, 810 T.M. (BNA), *Asset Protection Planning*, p. A-1.

² Restatement (Second) of Trusts ("Restatement Second"), section 157.

³ *Id.*

⁴ As discussed later, in a non-UTC state or non-hybrid trust state, exception creditors may recover only against a trust that is classified as a support trust, not against a trust classified as a discretionary trust.

⁵ Rather than using a property analysis, some courts will find that the beneficiary's interest has no ascertainable value. *Miller v. Dept. of Mental Health*, 442 N.W.2d 617 (Mich., 1989); *Henderson v. Collins*, 267 S.E.2d 202 (Ga., 1980); *In re Dias*, 37 BR 584 (D. Idaho, 1984). In essence, the analysis is the same—there is no interest or enforceable right that a creditor may attach because under this analysis the beneficial interest has no value.

⁶ Restatement Second, section 155, comment b.

⁷ *Miller v. Dept. of Mental Health*, *supra* note 5; Restatement Second, section 157; *Henderson v. Collins*, *supra* note 5; *In re Dias*, *supra* note 5.

⁸ *In re Bottom*, 176 B.R. 950 (N.D. Fla., 1994).

⁹ Restatement Second, section 161.

¹⁰ Restatement Second, section 162.

case, the analysis shifts to whether the trust has a spendthrift provision.

Similar to the analysis for a current distribution interest, spendthrift protection must be analyzed within the confines of the four exception creditors. Here again, a former spouse is an exception creditor who may attach a remainder interest for child support or alimony.

The control issue analysis is substantially identical for a current beneficial interest and a remainder interest. Even if the creditor is not an exception creditor or even if the trust is a discretionary trust, if the beneficiary holds too much control over the trust, a creditor will still be able to attach the beneficiary's interest and reach the trust assets.

In the domestic relations area, courts have granted a former spouse greater rights than an ordinary creditor or an exception creditor. As noted above, a spouse is an exception creditor, but only for purposes of alimony or child support. In many states, though, courts have allowed a spouse to attach a remainder interest as part of a property settlement.

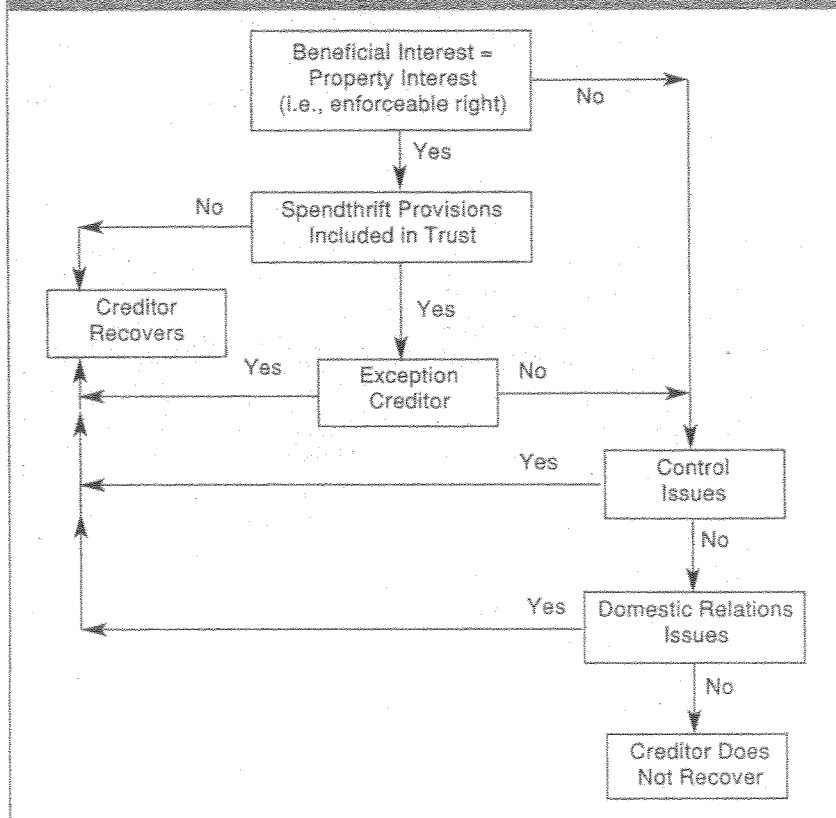
A flowchart for non-UTC states for creditor recovery of a remainder interest, including recovery by an estranged spouse, is provided in Exhibit 2.

Support trusts versus discretionary trusts

A trust is generally drafted as either: (1) a mandatory distribution trust, (2) a support trust (i.e., distributions pursuant to an ascertainable standard), or (3) a discretionary trust. Additionally, since many attorneys tend to com-

EXHIBIT 1

Creditor Recovery of a Current Beneficial Interest (Non-UTC State)



bine the language of a support trust with the language of a discretionary trust, a handful of states have created a fourth type of trust called a hybrid trust.

Mandatory distribution trust. A mandatory distribution trust is a trust in which the trustee *must* make the distribution required by the terms of the trust agreement. The trustee may not withhold or accumulate a mandatory distribution. Some examples of mandatory distribution trusts include marital deduction trusts, grantor retained annuity trusts, charitable remainder trusts and charitable lead trusts. The trusts in these examples require mandatory distributions in order to qualify for certain tax benefits. However, many trusts are drafted with mandatory distributions even

though there is no tax reason to do so. This often makes some or all of the trust assets available to the beneficiary's creditors and divorcing spouses for no reason except that the drafter was using a trust "form" that was inadequate for planning purposes.

Support trust. A support trust is created by the settlor to support one or more beneficiaries. A support trust directs the trustee to apply the trust income and/or principal as is necessary for the support, maintenance, education and welfare (or other standard) of a beneficiary.¹¹ The beneficiary of a support trust can compel the trustee to make a distribution merely by demonstrating that the money is necessary for the beneficiary's support, maintenance, education or welfare,¹² or whatever other standard is con-

¹¹ First Nat'l Bank of Maryland v. Dept. of Health and Mental Hygiene, 399 A.2d 891 (Md., 1979); Restatement Second, section 154.

¹² Chenot v. Bordenleau, 561 A.2d 891 (R.I., 1989); Eckes v. Richland County Social Services, 621 N.W.2d 851 (N.D., 2001); Restatement Second, section 128, comments d and e.

tained in the trust. The following is an example of language creating a support trust:

The Trustee *shall* make distributions of income or principal for the beneficiary's *health, education, maintenance and support.*

Implicit in this support language are two components: (1) a command that the trustee "shall" make distributions, and (2) under what standard or circumstances (i.e., health, education, maintenance and support) distributions are to be made.

A support trust typically includes mandatory language that the trustee "shall" make distributions.¹³ However, there are a few cases in which a trust has been classified as a support trust even though the discretionary word "may" or the words "discretion," and even "sole discretion," were used instead of the mandatory word "shall." The standard for distributions often contains words such as "health, education, maintenance and support." In some states, the standard may also include terms such as "comfort and welfare."¹⁴ A support trust gives the trustee discretion only with respect to the time, manner, or size of distributions needed to achieve a certain purpose, such as support of the beneficiary.¹⁵



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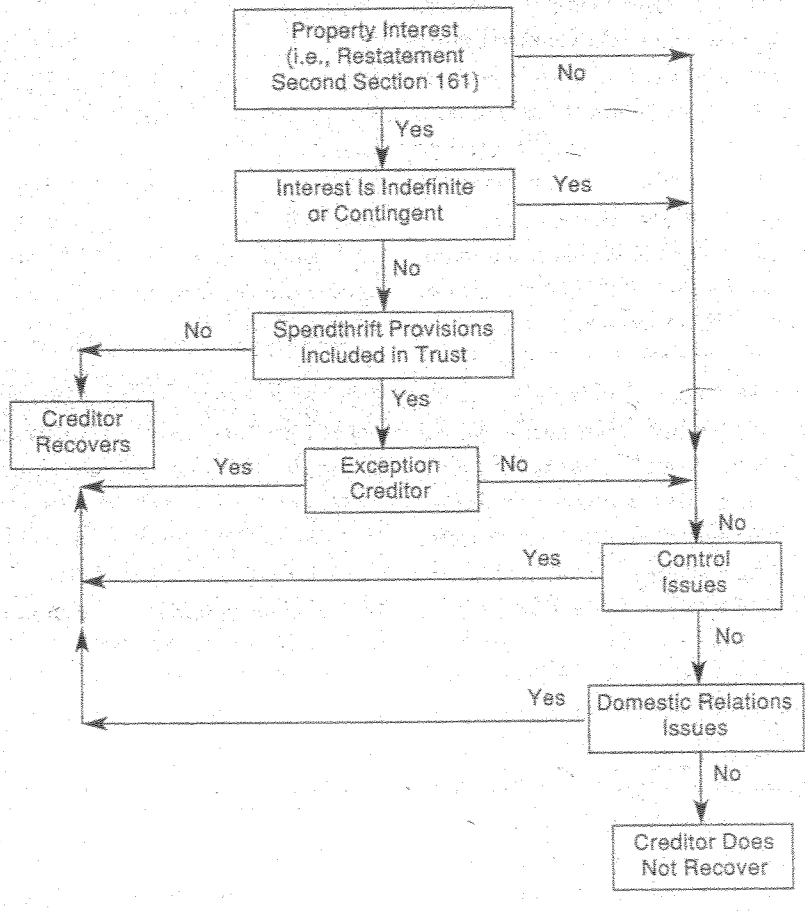
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EXHIBIT 2

Creditor Recovery of a Remainder Interest (Non-UTC State)



For example, in *McElrath v. Citizens and Southern Nat'l Bank*,¹⁶ the language "[t]he Trustee shall use a sufficient amount of the income to provide for the grandchild's support, maintenance and education" [emphasis added] was held to result in a support trust. Similarly, in *In re Carlson's Trust*,¹⁷ the language "[t]he trustee shall pay...[to the settlor's] daugh-

ters such reasonable sums as shall be needed for their care, support, maintenance, and education" [emphasis added] was determined to create a support trust. Finally, in *McNiff v. Olmsted County Welfare Dept.*,¹⁸ the court decided that the language "[t]he trustee shall administer the trust estate for the benefit of my wife and my said daughter, or the survivor of either,

¹³ Lineback by *Hutchens v. Stout*, 339 S.E.2d 103 (N.C. App., 1986).

¹⁴ For estate tax purposes, under IRC Section 2041, a "welfare" standard does not constitute an ascertainable standard and therefore results in a general power of appointment. However, for the definition of a support trust, in some states, a "welfare" standard is included within the ascertainable standard. Further, in some cases, language such as "comfort and general welfare" will also take the trust language outside that of

a general support trust. *Lang v. Commonwealth of Pa., Dept. of Public Welfare*, 528 A.2d 1335 (Pa., 1987); *Restatement Second*, section 154 and comments thereto. But see *Bohac v. Graham*, 424 N.W.2d 144 (N.D., 1988).

¹⁵ *Eckes v. Richland County Social Services*, *supra* note 12.

¹⁶ 189 S.E.2d 49 (Ga., 1972).

¹⁷ 152 N.W.2d 434 (S.D., 1967).

¹⁸ 176 N.W.2d 888 (Minn., 1970).

and the trustee *shall* apply the income in such proportion together with such amounts of principal as the trustee, in its discretion, deems advisable for the *maintenance, care, support and education* of both my wife and my said daughter” [emphasis added] created a support trust.

Discretionary trust. A discretionary trust allows the trustee complete and uncontrolled discretion to make allocations of trust funds if and when it deems appropriate.¹⁹ Because the trustee is given such broad powers, the beneficiary can compel the trustee to distribute funds only if it can be shown that the trustee is abusing its discretion by failing to act, acting dishonestly, or acting with an improper purpose in denying the beneficiary the funds sought.²⁰ The following is an example of language creating a discretionary trust:

The Trustee *may* distribute as much or more of the net income and principal as the Trustee, *in its sole and absolute discretion*, deems appropriate to or among any beneficiary or beneficiaries. The Trustee, in its sole and absolute discretion, at any time or times, may exclude any of the beneficiaries or may make unequal distributions among them.

Implicit in this magical discretionary language are three com-

ponents: (1) a discretionary statement that the trustee “may” make a distribution, (2) the trustee has the “sole and absolute” discretion to determine whether a distribution shall be made and, if so, how much shall be distributed, and (3) the ability to exclude distributions from other beneficiaries.

A discretionary trust generally uses permissive language such as the word “may” instead of the word “shall.”²¹ Nevertheless, as noted below, there are a few cases where the courts have held that the word “shall”—when combined with the words “sole and absolute” discretion—still resulted in a discretionary trust.²²

The permissive word “may” is still generally further qualified by granting the trustee unfettered discretion using words such as “sole and absolute discretion,” “absolute and uncontrolled discretion,” or “unfettered discretion.” In some cases, explicit language that permitted the trustees to exclude or discriminate between beneficiaries when making distributions was a major factor the court considered in determining whether a trust was a discretionary trust.²³

For example, in *In re Matter of Leona Carlisle Trust*,²⁴ the court determined that the language “[t]he Trustee *shall* expend such sums from the principal of the trust for the benefit of [appellant]...as the trustee, in its *full discretion, deems advisable*,” [emphasis added] and it “is expressly understood the trustee is under no obligation to make any expenditures,” created a discretionary trust. Furthermore, the trust language provided that the trustee shall not make any distributions for appellant’s “basic necessities as provided or to be provided by any governmental unit,” and the trustee “shall

make distributions only to supplement and not to supplant such public assistance available for maintenance, health care or other benefits.”²⁵

Similarly, in *Zeoli v. Comm’r of Social Services*,²⁶ the court found that the language “[t]o pay or apply so much of the net income to or among either one or both of my daughters as shall be living from time to time during the term of such trust, and in such proportions and amounts as my trustee shall determine in his *absolute and uncontrolled discretion*...” [emphasis added] created a discretionary trust. The language in that case continued, “[m]y trustee shall not be required to distribute any net income of such trust currently and may, in his *absolute and uncontrolled discretion*, accumulate any part or all of the net income of such trust, which such accumulated net income shall be available for distribution to the beneficiaries as aforesaid.” [Emphasis added.]

As yet another example, in *Simpson v. State Dept. of Social*



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¹⁹ First Nat’l Bank of Maryland v. Dept. of Health and Mental Hygiene, *supra* note 11.

²⁰ Town of Randolph v. Roberts, 195 N.E.2d 72 (Mass., 1964); Lineback, 339 S.E.2d at 106; Ridgell v. Ridgell, 960 S.W.2d 144 (Tex. App., 1997); Restatement Second, section 187, comment e.

²¹ State ex. rel. Secretary of SRS v. Jackson, 822 P.2d 1033 (Kan., 1991).

²² Myers v. Kansas Dept. of Social and Rehabilitation Services, 866 P.2d 1052 (Kan., 1994).

²³ McNiff v. Olmstead County Welfare Dept., 176 N.W.2d 888 (Minn., 1970).

²⁴ 498 N.W.2d 260 (Minn. App., 1993).

²⁵ *Id.*

²⁶ 425 A.2d 553 (Conn., 1979).

and Rehabilitation Services,²⁷ the trustees were required to distribute trust income and assets to any one or more of this group of beneficiaries as the trustees "in their absolute discretion" may determine from time to time. The instrument further provided that "the Trustees shall have the absolute discretion, at any time and from time to time, to make *unequal payments* or distributions to or among any one or more of said group and to *exclude* any one or more of them from any such payment or distribution." [Emphasis added.]

Hybrid trust or 'discretionary support trust.' There are three states and possibly a fourth (Iowa, Nebraska, North Dakota, and possibly Pennsylvania) that have taken the position that there is an additional type of trust—a "discretionary support trust." This type of trust includes elements of both a support trust and a discretionary trust.²⁸ A discretionary support trust is created when the settlor combines explicit discretionary language "with language that, in itself, would be deemed to create a pure support trust."²⁹

Under the case law of these three or four states, the hybrid trust covers the middle ground between a classic support trust and a clas-

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sic discretionary trust.³⁰ If a trust is neither a traditional support trust nor a traditional discretionary trust, these courts have used one or the other of the following two approaches. They have either (1) allowed extrinsic evidence to determine the classification as either a discretionary or a support trust, or (2) required the trustee to carry out the purposes of the trust based on a "good faith" standard and required the trustee to make minimal distributions.

An example of a case where the court allowed extrinsic evidence in order to make the determination is *Bohac v. Graham*.³¹ There, the provisions of the trust allowed the trustee to distribute principal as the "Trustee may deem necessary" for the beneficiary's "support, maintenance, medical expenses, care, comfort, and general welfare." [Emphasis added.] The court noted that the trust provisions created a hybrid trust, but decided that extrinsic evidence must be admitted to determine the settlor's intent with respect to whether the trust was a support trust or a discretionary trust. Even though the court noted that the words "comfort and general welfare" may result in the classification of the trust as a discretionary trust, the court held that the trust was a support trust.

As another example, in *Kryzsko v. Ramsey County Soc. Services*,³² the trustee was given sole discretion to invade trust principal for the "proper care, maintenance, support, and education" of the beneficiary. The court ruled that the trustee did not have unfettered dis-

cretion and must follow a standard of providing proper support. The court noted that unlike a discretionary trust, which fixes no standard on the trustee's absolute discretion as to whether to pay income or principal to a beneficiary, a support trust gives the trustee discretion only as to the time, manner, and size of the payments needed to achieve a certain purpose such as support of a beneficiary.

In *Lang v. Commonwealth of Pa., Dept. of Public Welfare*,³³ the trust provided that "the trustee shall pay the income periodically to or for the support, maintenance, welfare, and benefit of my son or may, in the trustee's discretion, add part or all of the income or principal to be invested as such." [Emphasis added.] The trust continued, "[t]he trustee may distribute such part of the income not necessary for the support of my son, in equal shares to my children." After looking at extrinsic evidence suggesting that the settlor's intent was to preserve trust assets, particularly where public benefits were available to the beneficiary, the court held that the trust was discretionary.

In contrast, in *Smith v. Smith*,³⁴ the Nebraska Supreme Court held that the trustee of a discretionary support trust can be compelled to carry out the purpose of the trust in good faith. The trust provided that "[T]he trustee shall pay over to, or for the benefit of one or more of the living members of a class composed of my son Richard and

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²⁷ 906 P.2d 174 (Kan. App., 1995).

²⁸ *Eckes v. Richland County Social Services*, *supra* note 12.

²⁹ *Abravanel*, "Discretionary Support Trusts," 68 Iowa L. Rev. 273, 279, n. 26 (1983).

³⁰ *Bohac v. Graham*, 424 N.W.2d at 144.

³¹ 424 N.W.2d 144, 146 (N.D., 1988).

³² 607 N.W.2d 237 (N.D., 2000).

³³ 528 A.2d 1335 (Pa., 1987).

³⁴ 517 N.W.2d 394 (Neb., 1994).

his issue, so much of the net income and principal of the trust as the Trustee shall deem to be in the best interests of each such person, from time to time. Such distributions need not be made equally unto all members of the class. In determining the amount and frequency of such distributions, the Trustee shall consider that the primary purpose of the trust is to provide for the health, support, care, and maintenance of my son Richard during his life." [Emphasis added.] The court concluded that the above language resulted in a "hybrid trust" where the trust was created not only to support the primary beneficiary, but also to grant the trustee greater liberty in decision-making than would be accorded a trustee of an ordinary support trust.

A few courts have held that the effect of a discretionary support trust is to establish the minimal distributions a trustee must make in order to comport with the settlor's

intent of providing basic support, while retaining broad discretionary powers in the trustee.³⁵ In these cases, the courts held that the minimum distribution may be reached by a creditor.³⁶

In *Bureau of Support in Dept. of Mental Hygiene & Correction v. Kreitzer*,³⁷ the Ohio Supreme Court, without using the term "hybrid trust," found the trust language to create neither a purely discretionary trust nor a purely support trust. Therefore, the court ruled that the trust should be governed by a "reasonableness" standard that would not permit the beneficiary to become destitute. The result was that the governmental agency could recover against the trust assets under the exception for necessary expenses of a beneficiary. Further, the Ohio Supreme Court seemed to lean further toward becoming a "hybrid trust" state when it stated in *Martin v. Martin*³⁸ (a subsequent case), that "[a] trust confer-

ring upon the trustees power to distribute income and principal in their absolute discretion, but which provides standards by which that discretion is to be exercised with reference to the needs of the trust beneficiary for education, care, comfort, or support is neither a purely discretionary trust nor a strict support trust."

This Ohio Supreme Court ruling is particularly troubling because it used a "reasonableness" standard. For over a hundred years, the strong majority view has been that the appropriate standard is bad faith or abuse (i.e., the trustee acts dishonestly with an improper motive or fails to act).³⁹ Moreover, the purpose of a discretionary trust is to prevent the courts from reviewing the "sole and absolute" discretion of the trustee. With a discretionary trust, the settlor has chosen to put his faith in the trustee rather than the courts. However,

³⁵ *Strojek by Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566 (Iowa App., 1999); *In re Sullivan's Will*, 12 N.W.2d 148 (Neb., 1943); *Abravanel*, *supra* note 29, at 290; 3 *Scott and Fratcher, The Law of Trusts*, section 187 at p. 15 (4th ed. 1988).

³⁶ *Strojek by Mills v. Hardin County Bd. of Supervisors*, *supra* note 35; *Abravanel*, *supra* note 29, at 290; *Frolik*, "Discretionary Trusts for a Disabled Beneficiary: A Solution or a Trap For the Unwary?," 46 U. Pitt L. Rev. 335, 342 (1985).

³⁷ 243 N.E.2d 83 (Ohio, 1968).

³⁸ 374 N.E.2d 1384 (Ohio, 1978).

³⁹ Different courts define the term "bad faith" slightly differently. As used in this article, "bad faith" means the trustee (1) acts dishonestly, (2) acts with an improper motive, or (3) fails to use his or her judgment. *In Re Jones*, 812 P.2d 1152 (Colo., 1991) (citing *Scott on Trusts*, section 130 at p. 409 (4th ed. 1989)). Also see the detailed analysis in *Scott on Trusts*, section 187 at p. 15, where it is noted that if the distribution standard includes enlarged or qualifying adjectives such as "sole and absolute discretion" combined with "no fixed standard by which the trustee can be determined is abusing his discretion...the trustee's discretion would generally be deemed final." Furthermore, section 187.2 provides, "[e]ven though there is no standard by which it can be judged whether the trustee is acting reasonably or not, or though by the terms of the trust he is not required to act reasonably, the court will interfere where he acts dishonestly or in bad faith, or where he acts from an improv-

er motive." This analysis by *Scott on Trusts* remains consistent through the 2003 supplemental volume. *Bogert in The Law of Trusts and Trustees* (2nd ed. 1980, Supplement through 2003) also seems to hold relatively the same definitional analysis as *Scott*. Section 560 of the Supplement at page 183 states that if a settlor has given a discretionary power (without qualification), the court is reluctant to interfere with the trustee's use of the power. Hence, in the absence of one or more of the special circumstances mentioned hereinafter, the court will not upset the decision of the trustee. These special circumstances (at page 196) are (1) a trustee fails to use his judgment, (2) an abuse of discretion, (3) bad faith, (4) dishonesty, and (5) an arbitrary action. Regarding the issue of "arbitrary action," *Bogert* provides, "[i]f the trustee has gone through the formality of using his discretion, but has not deliberately considered the arguments pro and con, and thus has made a decision for no reason at all, his conduct may be characterized as arbitrary and capricious, as amounting to a failure to use his discretion. In this respect, *Bogert* suggests that the "arbitrary" action is a subset of a trustee failing to act. Also, both *Scott* and *Bogert* note that a few states have statutes where unless the trust agreement contains language such as the "sole and absolute discretion" of the trustee, the trustee may not act arbitrarily. *Bogert*, 2003 Supp. at 199, n. 85; *Scott*, section 187.2, p. 39, n. 12; Cal. Prob. Code § 1608, enacted 1986 c.820; Mont. Code § 72-23-306 (1983); N.D. Cent. Code § 59-02-12; S.D. Codified Laws § 55-3-9 (1967).

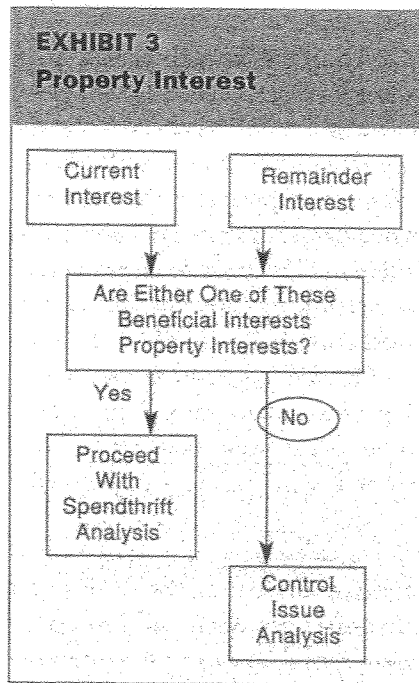
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a support trust takes the opposite approach. With a support trust, the settlor wants the beneficiary to have a right to enforce the ascertainable trust terms if the trustee does not follow the standard specified in the trust agreement.

By using a standard less than bad faith and closer to reasonableness, the Ohio Supreme Court has now given the beneficiary of this hybrid type of trust the right to sue the trustee for unreasonably not making a distribution or not distributing enough. Furthermore, this legal right will most likely be a property right (i.e., a right enforceable under state law) that can allow a creditor to stand in the shoes of the beneficiary.

What is a property interest?

Most courts first determine whether a beneficiary has a property interest under state law.⁴⁰ Rather than using a property analysis, some courts will find

that the beneficiary's interest has no ascertainable value.⁴¹ In essence, the analysis is the same. There is no interest or enforceable right that a creditor may attach because, under this analysis, the beneficial interest has no value.

Assuming the property analysis approach is used, the initial step in determining whether a creditor may recover against an interest in a trust is to determine whether the interest is a property interest under state law. See the flowchart that appears in Exhibit 3.

If the beneficiary's interest in the trust is not a property interest, then the analysis proceeds directly to whether the beneficiary held too much control over the trust, followed by any state nuances under domestic relations law.⁴² On the other hand, if the beneficiary holds a property interest, does the creditor stand in the shoes of the beneficiary, and may the creditor enforce the beneficiary's property right? The answers to these questions depend on whether the trust has a spendthrift provision and how much creditor protection the spendthrift provision provides.

State law determines what constitutes a property interest. While state law may vary, "property" is generally defined as everything that has an exchangeable value or that comprises wealth or estate.⁴³ An "equitable interest" in trust property is regarded as a property interest of the same kind as trusts and is more than a mere chose in action.⁴⁴ Simply, there are two types of property: (1) something that may be sold or exchanged, or (2) an enforceable right.

With regard to the first type of property, such property is freely

alienable, and as such has a fair market value that may be determined by a market price. However, beneficial interests in trusts are generally restricted by spendthrift provisions that prevent the transfer of any beneficiary's interest. In this respect, there is no fair market value because the property cannot be sold. On the other hand, in many situations, a beneficiary has an enforceable right (i.e., a property interest). For example, a current beneficiary of a support trust has a right to sue the trustee to force a distribution pursuant to a standard in the trust. Also, if a beneficiary has a vested remainder interest, the beneficiary will most likely receive property at some time in the future.

Part 2 of this article, which will appear in the next issue, will focus on the distribution standard and the current beneficial interest, remainder interests, spendthrift provisions, conflicting distribution language, and nuances under state domestic relations law. ■

⁴⁰ *Carlisle v. Carlisle*, 194 WL 592243 (Super. Ct. Conn., 1994); *Lauricella v. Lauricella*, 565 N.E.2d 436 (Mass., 1991).

⁴¹ *Miller v. Dept. of Mental Health*, *supra* note 5; *Henderson v. Collins*, *supra* note 5; *In re Dias*, *supra* note 5.

⁴² A creditor cannot recover against a beneficial interest that is not a property interest. *Magavern*, 550 F.2d 797, 39 AFTR2d 77-968 (CA-2, 1977) (reversing the state court, but still discussing the property interest issue). However, due to some state domestic relations statutes, a value may be assigned to a discretionary interest in a trust to determine what the other spouse should receive upon the divorce.

⁴³ *Graham v. Graham*, 194 Colo. 429; 574 P.2d 75, 76 (1978) (citing *Black's Law Dictionary*, 1382 [4th ed.]).

⁴⁴ *Senior v. Braden*, 295 U.S. 422 (S.Ct., 1935); *Brown v. Fletcher*, 235 U.S. 589 (S.Ct., 1915); II Fratcher, *Scott on Trusts* section 130 at 406 (1987).