Washington & Lee University School of Law
Washington & Lee University School of Law Scholarly Commons

Faculty Scholarship

1-1-2006

Article Five of the UTC and the Future of Creditors' Rights in Trusts

Robert T. Danforth
Washington and Lee University School of Law, danforthr@wlu.edu

Follow this and additional works at: http://scholarlycommons.law.wlu.edu/wlufac

Part of the Estates and Trusts Commons

Recommended Citation
Robert T. Danforth, *Article Five of the UTC and the Future of Creditors' Rights in Trusts*, 27 Cardozo L.Rev. 2551 (2006).

This Article is brought to you for free and open access by Washington & Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Washington & Lee University School of Law Scholarly Commons. For more information, please contact osbornecl@wlu.edu.

ARTICLE FIVE OF THE UTC AND THE FUTURE OF CREDITORS' RIGHTS IN TRUSTS

Robert T. Danforth[*]

Introduction 2552
I. Background 2553
  A. Development of the UTC and Its Adoption by the States 2553
  B. Criticisms of the UTC 2555
II. Operative Rules of Article Five 2557
  A. Rights of Creditors of Non-settlor Beneficiaries 2557
    1. Section 501 2557
    2. Section 502 2559
    3. Section 503 2560
    4. Section 504 2562
    5. Section 506 2565
  B. Rights of Creditors of Settlors 2566
III. Criticizing the Critics 2570
  A. Argument 1: The UTC Weakens the Creditor Protection Attributes of Spendthrift Trusts 2570
  B. Argument 2: Exception Creditors Are Granted Rights that Are Too Broad, and the List of Exception Creditors Can Readily Be Expanded 2572
  C. Argument 3: Eliminating the Distinction Between Support Trusts and Discretionary Trusts Compromises Protection from Creditors' Claims 2575
  D. Argument 4: The UTC Grants Enforceable Rights to Beneficiaries Not Held at Common Law 2579
  E. Argument 5: The UTC Compromises the Effectiveness of Supplemental-Needs Trusts 2587
  F. Argument 6: The UTC Increases the Exposure of Trust Assets in Divorce Proceedings 2591
  G. Argument 7: Drafting a Trust in a UTC Jurisdiction Constitutes Malpractice 2593
  H. Argument 8: The UTC is a "Regressive" Statute 2594
IV. Critical Analysis of the Code 2595
  A. Abolishing the Distinction Between Support and Discretionary Trusts 2595
  B. The Good Faith Standard of Section 814(a) 2598

[*] Associate Professor of Law and Alumni Faculty Fellow, Washington and Lee University. I thank the participants of the 2005 *Cardozo Law Review* symposium, Trust Law in the 21st Century, for their suggestions and comments; Alan Newman for reviewing an early draft of this article and providing suggestions and guidance; and the Frances Lewis Law Center, Washington and Lee University, for its financial support.

C. The Power to Compel Distributions Under Section 504(c) 2603
D. Some Modest Suggestions for Reform 2605
1. Clarifying or Modifying the Relationship Between Sections 501 and 503 2605
2. Clarifying or Modifying the Comment to Section 814(a) 2607
Conclusion 2608

INTRODUCTION

> [The Uniform Trust Code (UTC) constitutes a] radical departure . . . from common law regarding the traditional asset protection afforded by discretionary dynasty trusts as well as spendthrift trusts in general.[1]

> Mr. Merric's article contains numerous unsupported statements, mischaracterizations and misinformation about the UTC and about American trust law in general. Even worse, using scare tactics that take advantage of the fact that most state legislators' constituents lack trust law expertise, its clear intention is to undermine legislative support for the UTC.[2]

The Uniform Trust Code[3] is the first comprehensive codification of the law of trusts. Approved in 2000 by the National Conference of Commissioners on Uniform State Laws (NCCUSL), the UTC has since been enacted (sometimes in modified form) in at least a dozen jurisdictions. The UTC has not been without controversy. As evidenced by the epigraphs above, Article Five of the UTC—concerning creditors' rights—has generated a veritable war of words, with opponents claiming that enactment of the UTC will result in dire consequences to the traditional creditor-protection benefits associated with spendthrift and discretionary trusts. The purpose of this Article is to examine Article Five and the controversy it has engendered.

---

[1] Mark Merric & Steven J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?*, 31 EST. PLAN. 478, 478 (2004).

[2] Letter from David M. English et al., U.S. Trust Law Experts Respond to Attack on the Uniform Trust Code (Feb. 11, 2004), http://www.nccusl.org/nccusl/UTCResponse_Feb04.pdf (referencing Mark Merric et al., *The Uniform Trust Code, Is Arizona's Nightmare About to Become Yours?* (on file with Cardozo Law Review, previously available at http://www.internationalcounselor.com), [hereinafter *Arizona's Nightmare*]).

[3] Except as otherwise indicated, citations to the UTC and its comments reflect amendments through 2005.

Part I of the Article offers some background about the UTC and its development. Part I also describes, in summary fashion, some of the controversies that have surrounded the UTC—including the controversy over Article Five—and explains how these controversies have, in some cases, inhibited adoption of the UTC by the states.

Part II examines the operative rules of Article Five; the purpose of Part II is to set up the discussions in Parts III and IV. Part III of the article examines and responds to the critics' principal assertions about Article Five. Finally, Part IV offers a normative analysis of particular elements of Article Five and makes some modest suggestions for reform.

I. BACKGROUND

A. *Development of the UTC and Its Adoption by the States*[4]

The UTC is the product of over a decade of study and drafting by NCCUSL. The process began in 1993 with the appointment of a study committee chaired by Maurice Hartnett, a Delaware Supreme Court justice and former justice of the Delaware Chancery Court, with substantial experience in trust cases.[5] The function of the study committee was to decide whether the Uniform Law Commissioners should undertake the drafting of a comprehensive uniform law on trusts. The study committee recommended the formation of a drafting committee, which was appointed in 1994, with Judge Hartnett serving as its chair.[6] David M. English, now the Fratcher Professor of Law at the University of Missouri-Columbia, served as Reporter for the drafting committee.[7] The drafting committee was served by numerous advisors, which included representatives from the American Bar Association Section on Real Property, Probate and Trust Law, the American Bankers Association, and the American College of Trust and Estate Counsel.[8] In drafting the UTC, the committee considered the comprehensive trust statutes that already existed in some states—most notably California, Georgia, Indiana, and Texas[9]—and used the 1986

[4] This section of the Article borrows liberally from John E. Donaldson & Robert T. Danforth, *The Virginia Uniform Trust Code*, 40 U. RICH. L. REV. 325, 327-33 (2005).

[5] *See* David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 MO. L. REV. 143, 145 (2002).

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] David M. English, *Representing Estate and Trust Beneficiaries and Fiduciaries* (ALI-ABA Course of Study, Feb. 10-11, 2005), WL SK089 A.L.I.-A.B.A. 191, 193 (2005).

California statute as its initial drafting model. The drafters also drew heavily upon the common law as expressed in the American Law Institute's Restatement (Second) of the Law of Trusts, the emerging Restatement (Third) of the Law of Trusts, and the Restatement (Second) of Property (Wills and Other Donative Transfers).[10]

After approximately seven years of work in preparing the draft, the Uniform Law Commissioners approved the UTC on August 3, 2000.[11] Following a review of the NCCUSL Style Committee, the final text of the UTC was completed on October 9, 2000.[12] The official comments were completed on April 25, 2001.[13] The UTC was approved by the American Bar Association House of Delegates at its mid-year meeting in February 2001.[14] Technical amendments to the UTC were approved by NCCUSL in 2001, 2003, and 2004.[15] NCCUSL approved further amendments to the UTC in 2005, several of which concern Article Five.

As of the fall of 2005, the UTC, with some state-to-state variations, has been adopted in Arkansas, the District of Columbia, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Utah, Virginia, and Wyoming. Studies of the UTC undertaken by bar associations and special commissions are complete or nearing completion in a number of additional states. Legislative consideration of state versions of the UTC in late 2005 or early 2006 is expected in Alabama, Massachusetts, Ohio, and Pennsylvania. Bar association studies are underway in Colorado, Connecticut, Florida, Georgia, Idaho, Michigan, Montana, and Washington.

The UTC was also initially adopted in Arizona in 2003, but almost immediately following enactment, a small group of lawyers began a public campaign to have the UTC repealed. In December 2003, the Arizona legislature voted to delay the effective date of the UTC for two years, and the statute was eventually repealed in 2004. In Arizona, at the heart of the controversy were the claims of a small but vocal group of critics, whose claims are described briefly in the following section.

---

[10] *See* English, *supra* note 5, at 147-48.
[11] *See* English, *supra* note 9, at 193.
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*

B. *Criticisms of the UTC*

The UTC has been the subject of pointed criticism from a small segment of the estate planning bar, most of whom apparently focus their practices on so-called asset protection planning—that is, the structuring of clients' affairs to shelter assets from the claims of creditors. These lawyers have voiced their criticisms through numerous articles in professional journals,[16] through e-mail listserves,[17] on web sites devoted to the topic,[18] and through interviews with newspapers and magazines.[19] The most vocal of these critics has been Mark Merric, a Colorado lawyer specializing in asset protection planning, who has devoted the better part of the last several years in a campaign to prevent state legislatures from adopting the UTC. Mr. Merric has spoken and written prolifically about the UTC,[20] arguing in numerous ways that the UTC significantly erodes the creditor-protection attributes of trusts enjoyed under the common law. Most of Mr. Merric's criticism has focused on creditors' rights issues, and it is with this topic that this Article is principally concerned. Another frequent topic of criticism is the UTC provisions requiring trustees to furnish certain information to beneficiaries.

The latter topic of criticism led to an unusual sequence of events in Arizona. In 2003, a bill enacting the UTC was passed unanimously by the Arizona House and Senate and was signed into law by the Governor.

---

[16] *See generally* Mark Merric & Steven J. Oshins, *Effect of the UTC on the Asset Protection of Spendthrift Trusts*, 31 EST. PLAN. 375 (2004) [hereinafter *Effect of the UTC*]; Mark Merric & Steven J. Oshins, *UTC May Reduce the Asset Protection of Non-Self-Settled Trusts*, 31 EST. PLAN. 411 (2004) [hereinafter *Non-Self-Settled Trusts*]; Merric & Oshins, *supra* note 1; Mark Merric et al., *Malpractice Issues and the Uniform Trust Code*, 31 EST. PLAN. 586 (2004) [hereinafter *Malpractice Issues*]; Mark Merric & Douglas W. Stein, *A Threat to All SNTs*, 143 TR. & EST. 38 (2004); Mark Merric et al., *The Uniform Trust Code: A Divorce Attorney's Dream*, J. PRAC. EST. PLAN., Oct.-Nov. 2004, at 41 [hereinafter *A Divorce Attorney's Dream*].

[17] The principal vehicle for public criticism of the UTC has been the listserve sponsored by WealthCounsel, LLC, as described at http://wealthcounsel.com/listservs.aspx.

[18] See, for example, the web site for Merric Law Firm, LLC, at http://www.internationalcounselor.com, which includes numerous posting about the UTC.

[19] *See, e.g.*, Ashlea Ebeling, *The Great Trust Rebellion*, FORBES, Aug. 16, 2004, at 122; Rachel Emma Silverman, *Trust Laws Get a Makeover*, WALL ST. J., July 29, 2004, at D1.

[20] For a number of reasons—as will be more apparent from the discussion in Part III—Mr. Merric's criticisms of the UTC have been a source of considerable frustration for those who try to refute them. First, his explanations are often murky, making it a challenge to formulate a response. Second, his writings are hyperbolic—in his view, the effects of the UTC are not just undesirable, they are disastrous; those who read his articles uncritically approach the UTC with exaggerated concerns about its effects. Finally, an essential premise for his position—the status of creditors under the common law—is, in my view, incorrectly understood or, at least, incorrectly described. Thus, he views the UTC as shifting the law away from a position that arguably it never held. Assuaging the concerns of those about "changes" in the law is made more difficult by this faulty premise.

The bill had an effective date of January 1, 2004.[21] During the months following its enactment, the UTC became the subject of much controversy. Opponents of the UTC objected most vociferously to the provisions in the statute requiring a trustee to furnish information to beneficiaries.[22] According to the opponents, these provisions dramatically changed the common law rules governing information that must be provided to beneficiaries and seriously undermined the ability of settlors to keep information about their trusts private.[23] Opponents also objected on procedural grounds, claiming that the legislation had been enacted without adequate opportunity for public input.[24] The topic was the subject of substantial debate in the news media,[25] as well as on talk radio.[26] In December 2003, the legislature, in a special session,

---

[21] *See* Gordon Waterfall, *The Uniform Trust Code is Arizona-Bound*, 40 ARIZ. ATT'Y. 18 (2003).

[22] The significant reporting and disclosure duties imposed on trustees under the UTC are set forth in section 813 and may be summarized as follows. First, a trustee must keep "qualified beneficiaries" reasonably informed about the administration of the trust and material facts necessary to the protection of their interests; moreover, unless unreasonable under the circumstances, a trustee must respond promptly to requests from beneficiaries for information regarding administration matters. UNIF. TRUST CODE § 813(a) (2005); *see also id.* § 103(13) (defining "qualified beneficiary" to exclude those with remote, contingent interests). Second, upon request of a beneficiary (not limited to qualified beneficiaries) the trustee must promptly furnish a copy of the trust instrument. *Id.* § 813 (b)(1). Third, a trustee must notify qualified beneficiaries of any change in the method or rate of the trustee's compensation. *Id.* § 813(b)(4). Fourth, a trustee must, within 60 days of accepting a trusteeship, give notice to qualified beneficiaries of its acceptance and certain contact information. *Id.* § 813(b)(2). Fifth, within 60 days of learning that an irrevocable trust has been created or that a formally revocable trust has become irrevocable, the trustee must notify the qualified beneficiaries of the trust's existence, the identity of the settlor, the right to request a copy of the trust instrument, and (as discussed below) the right to receive annual reports. *Id.* § 813(b)(3). Finally, and most importantly, a trustee must furnish, at least annually, to distributees and permissible distributees (and to other qualified or non-qualified beneficiaries requesting the same) reports of receipts and disbursements, assets and liabilities, the amount of the trustee's compensation, and, if feasible, statements of the market value of assets on hand. *Id.* § 813(c).

Partly in response to the controversy in Arizona, the notice rules of section 813 were designated as "optional" in amendments adopted by NCCUSL in 2004. *See id.* § 105 cmt. (discussing 2004 amendments).

[23] *See generally* Mike Fimea, *Privacy Issues at Center of Revision Quest*, ARIZ. BUS. GAZETTE, Jan. 15, 2004, at 1.

[24] Paul Davenport, *Law Wasn't Controversial When Passed*, AP ALERT, Dec. 26, 2003.

[25] *See generally* Russ Wiles, *Veil of Privacy Will Be Removed Jan. 1*, ARIZ. REPUBLIC, Nov. 23, 2003, at 1; Russ Wiles, *Law Raises Questions for Creators of Trusts and for Beneficiaries*, ARIZZ. REPUBLIC, Nov. 23, 2003, at 4; Russ Wiles, *New Trust Law Rattles Estate Planners*, ARIZ. REPUBLIC, Dec. 7, 2003, at 4; Russ Wiles, *Trust Law Put on Hold Until 2006: State Bar Wants Time to Examine Impacts*, ARIZ. REPUBLIC, Dec. 16, 2003, at 1 [hereinafter *Trust Law Put on Hold*].

[26] *See* Davenport, *supra* note 24 (discussing the talk-radio program hosted by lawyer Keith DeGreen).

voted to delay the UTC's effective date,[27] and in April 2004 the Arizona UTC was repealed altogether.[28]

In their efforts to prevent the enactment of the UTC in other jurisdictions, Mark Merric and other opponents of the UTC have frequently cited the Arizona experience, claiming essentially that Arizona legislators successfully enacted the statute only because they were unaware of the UTC's serious deficiencies.[29] According to Mr. Merric and others, a significant reason that the statute was repealed in Arizona is that the Arizona legislature, upon further study, recognized the UTC as a "radical departure" from the common law concerning creditors' rights in trusts. As more fully discussed in Part III, in my view this is not a fair or reasonable characterization of the statute.

II. OPERATIVE RULES OF ARTICLE FIVE

This Part of the Article describes the principal operative rules of Article Five. Sections 501 through 504 and section 506 of the UTC govern the rights of creditors of beneficiaries who are not the settlor of a trust; it is these provisions with which this Article is principally concerned. Section 505 governs the rights of creditors of the settlor; although this Article is not primarily concerned with the rights of creditors of the settlor, it nevertheless discusses section 505, because the section is relevant to the rights of creditors of non-settlor beneficiaries holding withdrawal powers, who are treated as settlors to a limited extent. Moreover, as later discussed, unstated dissatisfaction with section 505 may underlie the critics' more overt complaints about other aspects of Article Five.[30]

A. *Rights of Creditors of Non-settlor Beneficiaries*

1. Section 501

Section 501 of the UTC, which applies in the rare case[31] in which a trust does not contain a spendthrift provision,[32] provides that "the court

[27] *See Trust Law Put on Hold*, *supra* note 25.

[28] *Napolitano Signs Repeal of Estate Planning Rules*, ARIZ. REPUBLIC, Apr. 24, 2004, at D3.

[29] *See, e.g.*, *Arizona's Nightmare*, *supra* note 2.

[30] *See infra* notes 175-180 and accompanying text (discussing the critics' complaint that the UTC is "regressive").

[31] Section 501 also applies in the even rarer case in which a spendthrift provision does not apply to the interest of a particular beneficiary or to a particular interest (such as the income interest) of a beneficiary. UNIF. TRUST CODE § 501 cmt. (2005) (first paragraph).

may authorize a creditor . . . of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."[33] As the official comment makes clear, section 501 "does not necessarily mean that the creditor can collect all distributions made to the beneficiary";[34] for example, "[t]he interest may be too indefinite or contingent for the creditor to reach."[35] Moreover, the statute also provides that "[t]he court may limit the award to such relief as is appropriate under the circumstances."[36] The comment explains the purpose of this language as follows:

> Because proceedings to satisfy a claim are equitable in nature, the second sentence of this section ratifies the court's discretion to limit the award as appropriate under the circumstances. In exercising its discretion to limit relief, the court may appropriately consider the circumstances of a beneficiary and the beneficiary's family.[37]

---

[32] Section 501, as amended in 2005, provides:

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

UNIF. TRUST CODE § 501 (2005). Before the 2005 amendment, the statute provided:

> 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 other means. The court may limit the award to such relief as is appropriate under the circumstances.

UNIF. TRUST CODE § 501 (2003) (amended 2005) (emphasis added). The 2005 amendment changed the italicized phrase from "is not protected by" to "is not subject to"; the comment accompanying the amendment explains the change as follows:

> A 2005 amendment changes "protected by" to "subject to" in the first sentence of the section. No substantive change is intended. The amendment was made to negate an implication that this section allowed an exception creditor to reach a beneficiary's interest even though the trust contained a spendthrift provision. The list of exception creditors and their remedies are contained in Section 503. Clarifying changes are also made in the comments and unnecessary language on creditor remedies omitted.

UNIF. TRUST CODE § 501 cmt. (2005) (discussing 2005 amendments). The comment to section 501, as amended in 2005, further states that "[t]his section applies only if the trust does not contain a spendthrift provision or the spendthrift provision does not apply to a particular beneficiary's interest." *Id.* Thus, section 501 is properly interpreted as applying only to such trusts and not to claims by exception creditors against trusts that include spendthrift provisions; the remedies available to an exception creditor are described in section 503. The purpose of the 2005 amendment to section 501 was to resolve ambiguity in the statute concerning this issue.

[33] UNIF. TRUST CODE § 501.

[34] *Id.* § 501 cmt.

[35] *Id.*

[36] *Id.* § 501.

[37] *Id.* § 501 cmt.

Thus, for example, the statute apparently would permit a court to deny distributions to a creditor if the support needs of the beneficiary or the beneficiary's dependents could not otherwise be met.[38]

2. Section 502

Section 502[39] establishes several fundamental rules. First, a spendthrift provision in a trust is valid only if it restrains both voluntary and involuntary transfers of a beneficiary's interest.[40] Thus, consistent with traditional doctrine, a provision that purports to restrict either voluntary or involuntary transfers alone will succeed in restricting neither type of transfer. Second, a settlor can establish spendthrift protection for a trust simply by stating that "the interest of a beneficiary is held subject to a 'spendthrift trust,' or words of similar import."[41] Finally, and most importantly, if an interest in trust is subject to a valid spendthrift provision, "[a] beneficiary may not transfer [the] interest" and "a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary."[42] The statute also provides that the general rule may be subject to exceptions established elsewhere in the statute;[43] this presumably constitutes a reference to section 503, which governs the rights of so-called exception creditors—those given access to trust interests

---

[38] This statutory concept is based in large part on language from a comment to section 56 of the Restatement (Third) of the Law of Trusts:

> [T]he court will give creditors relief that is fair and reasonable under the circumstances. If the beneficiary has only a right to the trust income or a right periodically to receive ascertainable or discretionary (but see § 60) payments, the court will normally direct the trustee to make the payments to the creditor until the claim, with interest, is satisfied. The court, however, may order less than all of the payments to be made to the creditor, leaving some distributions for the actual needs of the beneficiary and his or her family.

RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. e (2003).

[39] Section 502 provides:

> (a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.
>
> (b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
>
> (c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

UNIF. TRUST CODE § 502 (2005).

[40] *Id.* § 502(a).

[41] *Id.* § 502(b).

[42] *Id.* § 502(c).

[43] *See id.* (indicating that the general rule limiting creditor and assignee access to spendthrift trust interests applies "except as otherwise provided in this [article]").

notwithstanding spendthrift protection. The comment to section 502 limits the application of the general rule by stating that "[a] spendthrift provision is ineffective against a beneficial interest retained by the settlor."[44] This statement is consistent with section 505, as discussed in Part II.B.

3. Section 503

Section 503 creates several categories of exception creditors and establishes the remedies available to them.

The three categories of exception creditors are set forth in subsection (b) of section 503 as follows:

> A spendthrift provision is unenforceable against:
>
> (1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;
>
> (2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and
>
> (3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.[45]

The first and third categories of exception creditors are consistent with traditional doctrine, although several enacting jurisdictions have opted to delineate these categories more narrowly.[46] The second category, although not entirely consistent with the common law,[47] is based on section 59(b) of the Restatement (Third) of Trusts, and is also consistent with the prior two Restatements. As explained in the comment to section 503, its purpose is to "allow[] a beneficiary of modest means to overcome an obstacle preventing the beneficiary's obtaining services essential to the protection or enforcement of the beneficiary's rights under the trust."[48] Thus, for example, the beneficiary's lawyer in trust litigation would be entitled to recover from the trust if the lawyer obtains a judgment against the beneficiary for the

---

[44] *Id.* § 502 cmt.

[45] *Id.* § 503(b).

[46] *See, e.g.*, VA. CODE ANN. § 55-545.03.B. (2005) (omitting spouses and former spouses from the list).

[47] *See* RESTATEMENT (THIRD) OF TRUSTS § 59 reporter's notes to cmts. c & d (2003).

[48] UNIF. TRUST CODE § 503 cmt. (2005).

lawyer's fee. Note that, unlike the Restatements,[49] the statute does not create an exception for suppliers of necessaries, or for tort victims.[50]

Notably, section 503 is of limited effect—under subsection (c), it permits an exception creditor to "obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary."[51] As explained in the comment, "[d]istributions subject to attachment [under this provision] include distributions required by the express terms of the trust, such as mandatory payments of income, and distributions the trustee has otherwise decided to make, such as through the exercise of discretion."[52] The comment emphasizes this point by further explaining that section 503 "*does not authorize* [an exception creditor] *to compel a distribution* from the trust."[53] In other words, section 503 simply makes a spendthrift provision ineffective as to certain categories of claims and claimants; the claimant must still overcome other obstacles to recovering from the trust, such as language in the trust granting the trustee discretion in making distributions. Moreover, even if a claimant succeeds in attaching a beneficiary's interest, section 503 provides, as in section 501, that "[t]he court may limit the award to such relief as is appropriate under the circumstances." Essentially, in formulating an award for a particular claim, the court is expressly permitted to consider the support needs and other financial circumstances of the beneficiary and the beneficiary's family.[54]

---

[49] *See* RESTATEMENT (THIRD) OF TRUSTS § 59(b) (providing that, notwithstanding a spendthrift provision, a beneficiary's interest can be reached in satisfaction of a claim for "services or supplies provided for necessities").

[50] The official comment to section 503 explains these omissions as follows:

> Unlike Restatement (Third) of Trusts Section 59(2) (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 157(b) (1959), this Code does not create an exception to the spendthrift restriction for creditors who have furnished necessary services or supplies to the beneficiary. Most of these cases involve claims by governmental entities, which the drafters concluded are better handled by the enactment of special legislation as authorized by subsection (b)(3). The drafters also declined to create an exception for tort claimants. For a discussion of the exception for tort claims, which has not generally been recognized, see Restatement (Third) of Trusts Section 59 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999).

UNIF. TRUST CODE § 503 cmt.

[51] Note that this remedy is more limited than that available under section 501, which also permits a creditor to reach the beneficiary's interest by "other means," language intended to authorize a court to order the sale of a beneficiary's interest. *See infra* notes 219-221 and accompanying text.

[52] UNIF. TRUST CODE § 503 cmt.

[53] *Id.* (emphasis added).

[54] *See supra* notes 31-33 and accompanying text (discussing the identical language contained in section 501).

4. Section 504

Section 504, the portion of the statute that has generated the most controversy, contains rules determining creditors' rights with respect to distributions subject to a trustee's discretion. The general rule, stated in subsection (b), provides that,

> whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:
>
> (1) the discretion is expressed in the form of a standard of distribution; or
>
> (2) the trustee has abused the discretion.

Section 504(b) deliberately eliminates the distinction between discretionary trusts and so-called support trusts—the latter being trusts in which distributions are subject to a standard, such as one pertaining to the beneficiary's support, health, or education.[55] The comment to section 504 makes clear that, "[b]y eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both."[56] Both the statute and the comment also make clear that eliminating the distinction affects only the rights of creditors—it does not affect the right of a beneficiary to compel a distribution, which, under section 504(d), a beneficiary has the right to do if the trustee has abused its discretion or failed to comply

[55] Most trusts that establish standards for making distributions (as opposed to wholly discretionary interests) also grant the trustee some discretion in executing the standard. A typical provision might state that the trustee "may pay to or for the benefit of X such amounts of income and principal as shall be necessary for X's support, health, or education" or "shall pay to or for the benefit of X such amounts of income and principal as the trustee deems necessary for X's support, health, or education." Note that, regardless of whether the dispositive language is phrased as mandatory ("shall pay") or discretionary ("may pay"), in both cases the trustee must make discretionary determinations—in the second example, although the dispositive provision is phrased as mandatory, the trustee must exercise its discretion in determining what is "necessary." Only rarely will a dispositive provision subject to a standard fail to include language granting the trustee discretion—for example, the trustee "shall pay to or for the benefit of X such amounts of income and principal as shall be necessary for X's support, health, or education." Whether this language grants the trustee discretion, and thus would be subject to section 504(b), is an open question. In my view, the proper answer is "yes," because the trust implicitly contemplates that the trustee will exercise its discretion in determining the timing and amount of distributions "necessary" under the circumstances. A support provision granting the trustee no discretion whatsoever would presumably be treated as purely mandatory, in which case it would be subject to the rules of section 506, as discussed in Part II.A.5. *See also infra* note 114 (discussing a 2005 amendment clarifying that support standards will be interpreted as granting the trustee discretion).

[56] UNIF. TRUST CODE § 504 cmt.

with a standard for distribution.[57] Section 504(d) is discussed further below.

The general rule of section 504(b) is subject to an important exception. Under section 504(c),

> [t]o the extent a trustee has not complied with a standard of distribution or has abused a discretion:
>
> (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and
>
> (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

Note that the exception applies only to claims of children, spouses, and former spouses;[58] other categories of creditors are not afforded the benefits of this provision. Note also that the exception applies only to claims for support; thus, it presumably would not apply to a claim in connection with an equitable distribution order, nor would it apply to other types of claims of a child, spouse, or former spouse (such as a claim for money damages or restitution). Finally, note carefully two limitations on the amounts that may be paid in satisfaction of any claim. First, the amount paid cannot exceed the amount that the trustee would have been required to distribute, assuming that the trustee complied with the applicable standard and did not abuse his or her discretion. In other words, the claimant's access to the trust assets cannot exceed that of the beneficiary. Moreover, the claimant can reach only amounts that the trustee would have been *required* to distribute, not amounts that the trustee would have been permitted to distribute. Second, the amount paid must be "equitable under the circumstances"; thus, a successful

---

[57] Section 504(d) provides that "[t]his section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution." *Id.* § 504(d). The comment states that

> [e]liminating this distinction [between discretionary and support trusts] affects only the rights of creditors. The affect [sic] of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. See Section 814 comment.

Id. § 504 cmt. The comment further states that, "[u]nder subsection (d), the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary." *Id.*

[58] A number of adopting jurisdictions have modified section 503(b) to allow claims by children only. *See, e.g.*, VA. CODE ANN. § 55-545.03.B (2005).

claimant is not automatically entitled to the maximum amount that would have been distributed to the beneficiary.[59]

Section 504(d) makes clear that section 504 "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."[60] Thus, the rights of beneficiaries with respect to discretionary distributions exceeds the rights of creditors, except for the categories of creditors and claims described in subsection (c). As discussed in Part III.D, section 504(b) has generated some concern among the UTC critics, in particularly that section 504(d), in combination with section 814(a)—the latter of which requires a trustee to exercise discretionary powers "in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries"[61]—expands the powers of beneficiaries to compel distributions beyond the powers held at common law. As later discussed in Part III.D, in my view this concern is misplaced.

Section 504(e)[62] was added to the UTC in 2004 to limit the circumstances in which the assets of a trust can be reached by the creditors of a beneficiary by virtue of the beneficiary's status as trustee. Under this provision, as long as a trustee's power to make distributions for his or her own benefit is limited to an "ascertainable standard," "a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee."[63] The 2004 amendment also added section 103(2), which assigns the same meaning to "ascertainable standard" as in the Internal Revenue Code.[64] As

---

[59] *But see* UNIF. TRUST CODE § 504 cmt. (noting that, in fixing the amount that would be equitable under the circumstances, "the court having jurisdiction over the trust should consider that in setting the respective support award, the family court has already considered the respective needs and assets of the family").

[60] *Id*. § 504(d).

[61] The full text of section 814(a) is as follows:

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

Id. § 814(a). "Interests of the beneficiaries" is a defined term: under section 103(8), it means "the beneficial interests provided in the terms of the trust." *Id.* § 103(8).

[62] Section 504(e) provides:

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

Id. § 504(e).

[63] *Id.*

[64] Section 103(2) provides:

explained in the official comment, section 504(e) was added because beneficiaries routinely serve as trustees, and a rule allowing creditors to reach trust assets under those circumstances would "unduly disrupt standard estate planning."[65]

5. Section 506

Section 506 provides that, "[w]hether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal . . . if the trustee has not made the distribution . . . within a reasonable time after the designated distribution date."[66] As explained in the comment, the principle underlying this rule is that, upon the expiration of a reasonable period after the designated distribution date, "payments mandated by the express terms of the trust 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."[67] A significant 2005 amendment added a new subsection (a), which furnishes a helpful definition:

> "Ascertainable standard" means a standard relating to an individual's health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code] [amendment] [, or as later amended].

Id. § 103(2) (alterations in original). Sections 2041(b)(1)(A) and 2514(c)(1) of the Internal Revenue Code are both provisions excluding from the definition of a taxable general power of appointment "[a] power to consume, invade, or appropriate property for the benefit of [the power holder] which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the [power holder]." I.R.C. §§ 2041(b)(1)(A), 2514(c)(1) (2000).

[65] UNIF. TRUST CODE § 504 cmt. (discussing 2004 amendments). The comment elaborates on this point as follows:

> The UTC, as previously drafted, did not specifically address the issue of whether a creditor of a beneficiary may reach the beneficial interest of a beneficiary who is also a trustee. However, Restatement (Third) of Trusts §60, comment g, which was approved by the American law Institute in 1999, provides that the beneficial interest of a beneficiary/trustee may be reached by the beneficiary/trustee's creditors. Because the UTC is supplemented by the common law (see UTC Section 106), this Restatement rule might also apply in states enacting the UTC. The drafting committee has concluded that adoption of the Restatement rule would unduly disrupt standard estate planning and should be limited. Consequently, Section 504 is amended to provide that the provisions of this section, which generally prohibit a creditor of a beneficiary from reaching a beneficiary's discretionary interest, apply even if the beneficiary is also a trustee or cotrustee. The beneficiary-trustee is protected from creditor claims to the extent the beneficiary-trustee's discretion is protected by an ascertainable standard as defined in the relevant Internal Revenue Code sections. The result is that the beneficiary's trustee's interest is protected to the extent it is also exempt from federal estate tax. The amendment thereby achieves its main purpose, which is to protect the trustee-beneficiary of a bypass trust from creditor claims.

Id.

[66] *Id.* § 506(b).

[67] *Id.* § 506 cmt.

> In this section, "mandatory distribution" means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.[68]

The primary purpose of this amendment was to remove any doubt that a distribution pursuant to a standard should *not* be considered a mandatory distribution for purposes of section 506. As explained in the comment, the rights of creditors with respect to distributions pursuant to a standard are addressed under section 504 only, and not under section 506.[69]

B. *Rights of Creditors of Settlors*

Section 505 of the UTC governs the rights of creditors with respect to a trust created for the benefit of the settlor. In most respects it follows traditional doctrine, with some minor innovations. The section principally addresses three topics: (i) in subsection (a)(1), the rights of creditors of the settlor of a revocable trust during the settlor's lifetime; (ii) in subsection (a)(2), the rights of creditors of the settlor of an irrevocable trust; and (iii) in subsection (a)(3), the rights of creditors of the settlor of a revocable trust following the settlor's death. Section 505, in subsection (b), also describes the circumstances in which a beneficiary holding a withdrawal power will be treated as a settlor for purpose of these rules.

---

[68] *Id.* § 506(a).

[69] *Id.*506 cmt. As further explained in the comment:

> The [2005] amendment:
>
> . . .
>
> •correlates the definition of "mandatory distribution" in this section to the broad definition of discretionary trust used in Section 504. Under both Sections 504 and 506, a trust is discretionary even if the discretion is expressed in the form of a standard, such as a provision directing a trustee to pay for a beneficiary's support;
>
> •addresses the situation where the terms of the trust couple language of discretion with language of direction. An example of such a provision is "my trustees shall, in their absolute discretion, distribute such amounts as are necessary for the beneficiary's support." Despite the presence of the imperative "shall," the provision is discretionary, not mandatory. For a more elaborate example of such a discretionary "shall" provision, see Marsman [v]. Nasca, 573 N.E. 2d 1025 (Mass. Ct. App. 1991).
>
> •is clarifying. No change of substance is intended by this amendment. This amendment merely clarifies that a mandatory distribution is to be understood in its traditional sense such as a provision requiring that the beneficiary receive an income or receive principal upon termination of the trust.

Id. § 506 cmt.

Section 505(a)(1) provides that, whether or not a trust contains a spendthrift provision, "[d]uring the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors." This rule is not terribly controversial—it treats the assets of a revocable trust as if they were owned by the settlor himself, thus bringing the treatment of revocable trusts for creditors' rights purposes in line with the treatment of such trusts for federal tax purposes.[70] The rule is inconsistent with the common law,[71] but few if any courts would likely endorse the common law position today.

Section 505(a)(2) follows traditional doctrine in providing:

> With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.[72]

---

[70] Under sections 2036 and 2038 of the Internal Revenue Code, the assets of a revocable trust may be included in the settlor's estate for estate tax purposes, I.R.C. §§ 2036, 2038 (2000); under section 676 of the Code, the settlor is treated as the owner of the trust assets for income tax purposes, I.R.C. § 676.

[71] The common law, as expressed in the Restatement (Second), draws a subtle distinction between the rights of creditors arising as a consequence of a settlor's power of revocation and the rights of creditors arising as a consequence of a settlor's interests as a beneficiary. As to the former, the Restatement (Second) takes the position that "a power of revocation reserved by the settlor cannot be reached by his creditors. If he revokes the trust and recovers the trust property, the creditors can reach the property; but they cannot compel him to revoke the trust for their benefit." RESTATEMENT (SECOND) OF TRUSTS § 330 cmt. o (1959). As to the latter, the Restatement (Second) provides that the settlor's creditors "can reach the maximum amount which the trustee . . . could pay to him or apply for his benefit." *Id.* § 156(2). Because most revocable trusts also authorize unlimited distributions to the settlor, the distinction would have no practical import in most cases—the distinction would be principally relevant in the unusual case of a revocable trust in which the settlor did not retain a beneficial interest.

[72] UNIF. TRUST CODE § 505(a)(2). Section 505(a)(2) may differ from traditional doctrine in one significant respect, although the difference may also be simply the product of a drafting oversight. Section 505(a)(2) provides that a creditor of the settlor may reach the maximum amount that could be distributed for the settlor's benefit, but the section does not expressly provide that a spendthrift provision is ineffective with respect to an interest retained by the settlor. *See id.* In contrast, section 156 of the Restatement (Second) of Trusts, which is often cited as the definitive statement of the traditional rule, provides *both* that a creditor of the settlor may reach the maximum amount that could be distributed for the settlor's benefit, *see* RESTATEMENT (SECOND) OF TRUSTS § 156(2), *and* that a spendthrift provision for a settlor is ineffective. *See id.* § 156(1). The practical significance of this difference is that, under the UTC, although a settlor's creditor would have the ability to overcome discretionary limits on the settlor's interest in the trust, the creditor may not have the ability to force a judicial sale of a non-discretionary interest.

One explanation for this difference may be that it simply reflects a drafting oversight—the comment to section 502 states that a spendthrift provision is ineffective with respect to a settlor's interest, and the comment describes that rule as a "necessary corollary to § 505(a)(2)." UNIF. TRUST CODE § 502 cmt. Nevertheless, section 502 provides that spendthrift provisions are valid "except as otherwise provided in this [article]," and nothing in Article 5—including section 505(a)(2)—establishes an exception for an interest retained by a settlor. *Id.* § 502(c) (alteration in

As explained in the comment:

> The drafters of the Uniform Trust Code concluded that traditional doctrine reflects sound policy. Consequently, the drafters rejected the approach taken in States like Alaska and Delaware, both of which allow a settlor to retain a beneficial interest immune from creditor claims. . . . Under the Code, whether the trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. If the trustee has 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.[73]

As I have argued elsewhere, this rule in effect grants a settlor's creditors greater rights than those held by the settlor himself. In exercising its discretion to distribute income or principal to the settlor, a trustee has a fiduciary duty to consider the interests of all trust beneficiaries (not just the interests of the settlor) and thus cannot simply accede to the demands of the settlor for distributions; allowing a creditor to reach the maximum amount that could be distributed to the settlor ignores the limitations on the settlor's access to the trust fund imposed as a consequence of this fiduciary principle.[74] Nevertheless, the rule expressed in section 505(a)(2) has heretofore been widely accepted by courts and thus is likely current law in all jurisdictions, other than those—such as Alaska and Delaware—with legislation expressly changing the rule.

Section 505(a)(3) provides that, following the settlor's death, the assets of a revocable trust are subject to the claims of the settlor's creditors, costs of administering the settlor's estate, statutory allowances in favor of the settlor's spouse and children, and additional amounts that might otherwise be payable from the settlor's probate estate. Section 505(a)(3) applies only "to the extent the settlor's probate estate is inadequate to satisfy those claims."[75] This rule has been relatively non-controversial.

The statute also addresses the circumstances under which a person holding a withdrawal power will be treated as a settlor for purposes of these rules. Subsection (b)(1) of section 505 provides 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

original).

[73] UNIF. TRUST CODE § 505(a)(2) cmt.

[74] *See* Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 HAST. L.J. 287, 348-53 (2002).

[75] UNIF. TRUST CODE § 505(a)(3).

extent of the property subject to the power."[76] As explained in the comment, this subsection "treats a power of withdrawal as the equivalent of a power of revocation because the two powers are functionally identical."[77] Subsection (b)(2) provides that,

> upon the lapse, release, or waiver of the power [of withdrawal], the holder is treated as the settlor . . . only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in [sections 2041(b)(2), 2514(e), or 2503(b)[78] of the Internal Revenue Code].[79]

Thus, a beneficiary who holds a so-called *Crummey* withdrawal power[80] would be treated under subsection (b)(1) as the owner of trust property (in the amount of the withdrawal right) while the power was in effect. Yet, under subsection (b)(2), the beneficiary would not be treated as owner after the power lapsed, assuming that the amount that could be withdrawn was limited to the amount specified in section 2514(e).[81]

---

[76] The full text of subsection (b) provides:

> For purposes of this section:
>
> (1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and
>
> (2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in each case as in effect on [the effective date of this [Code]] [, or as later amended].

Id. § 505(b)(1) (alteration in original).

[77] *Id.* § 505 cmt.

[78] Sections 2041(b)(2) and 2514(e) establish special estate and gift tax rules, under which a lapse of a general power of appointment, which otherwise would trigger estate or gift tax consequences, is insulated from those consequences as long as the property that could have been appointed is less than or equal to the greater of (i) five thousand dollars or (ii) five percent of the value of the assets out of which the power could have been exercised. *See* I.R.C.§§ 2041(b)(2), 2514(e) (2000). Withdrawal powers subject to the "five or five" limitation, as well as withdrawal powers that lapse to the extent of that limitation, are routine aspects of estate planning for individuals with transfer tax concerns. Section 2503(b) refers to the $10,000 (as indexed for inflation) annual exclusion from the gift tax. *See id.* § 2503(b).

[79] UNIF. TRUST CODE § 505(b)(2).

[80] Named for the case, *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968), that first approved the use of this technique for obtaining gift tax annual exclusion treatment for transfers to irrevocable trusts.

[81] There is a slight mismatch between the language of section 505(b)(2) of the UTC and the language of sections 2041(b)(2) and 2514(e) of the Internal Revenue Code. Under section 505(b)(2) the holder of a withdrawal power avoids settlor status whether the withdrawal power lapses, is released, or is waived. *See* UNIF. TRUST CODE § 505(b)(2). Under sections 2041(b)(2) and 2514(e), on the other hand, the holder of a withdrawal power avoids the estate or gift tax consequences of that power only if the power lapses; a release or a waiver of the withdrawal power, unless it satisfied the special rules for qualified disclaimers under section 2518 of the Internal Revenue Code, would be treated as an estate or gift taxable event. *See* I.R.C. §§ 2041(b)(2), 2514(e).

This rule facilitates the common practice of granting beneficiaries *Crummey* withdrawal powers and withdrawal powers subject to the so-called "five or five" limitations[82] of sections 2041(b)(2) and 2514(e), without exposing the trust assets to the claims of the beneficiaries' creditors.[83]

III. CRITICIZING THE CRITICS

As discussed briefly in Part I, Article Five of the UTC has been subject of pointed criticism, with the critics claiming that the UTC represents a significant erosion of the creditor protection attributes of trusts at common law. In many respects the arguments of the critics are murky, making it difficult to formulate coherent responses. Nevertheless, Part III of the Article attempts to identify and analyze the critics' principal arguments.

A. *Argument 1: The UTC Weakens the Creditor Protection Attributes of Spendthrift Trusts*

The critics argue generally that the UTC weakens the creditor protection attributes of spendthrift trusts.[84] For the most part, this generalized argument is unsubstantiated, and for good reason—for it appears to have little basis in law or fact.

The spendthrift protection afforded by section 502 of the UTC is consistent with the attributes of spendthrift trusts at common law. If a beneficiary's interest is subject to a valid spendthrift provision, a creditor of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary. Note that the protection afforded by this rule operates both to prevent a court from forcing a sale of an interest for the benefit of a creditor and to prevent a court from ordering that future distributions be made to a creditor.[85] A spendthrift

[82] *See supra* note 78.

[83] *See* UNIF. TRUST CODE § 505 cmt.

[84] Merric & Oshins, *supra* note 1, at 478.

[85] This point has been the source of apparent confusion. In one of their articles, Mark Merric and Steven J. Oshins express their concern that section 501 of the UTC will be interpreted in such a manner that, although a creditor could not recover directly from a spendthrift trust, a creditor could nevertheless "attach the interest in the trust and merely wait [until the trustee decides to make a distribution] for satisfaction of his or her claim." *Id.* at 485. The authors apparently believe that the UTC would allow a creditor to attach the beneficiary's interest, after which any distributions that the trustee decided to make would be required to be made to the creditor. This perspective is based on a misunderstanding of section 501, which applies only to trusts or beneficial interests that are not protected by spendthrift provisions. As long as (i) the trust

provision is valid under the UTC only if it restrains both voluntary and involuntary transfers of the beneficiary's interest, but this limitation is consistent with the law in virtually every jurisdiction in the United States. The UTC makes it easy for a drafter to create a valid spendthrift trust—under section 502(b), simply stating that a beneficiary's interest is subject to a "spendthrift trust" is sufficient to incorporate all the protections of section 502.

The UTC, under section 503, creates a modest list of so-called exception creditors—specific categories of creditors, with specific types of claims, against whom a spendthrift provision is ineffective. The exceptions for children, spouses, and former spouses for their claims of support are consistent with the majority rule in the United States.[86] Moreover, the UTC fails to include as exception creditors, and thus strengthens the protections of a spendthrift provision, various other categories of creditors that have been recognized from time to time by the courts, such as suppliers of necessaries or tort claimants. Furthermore, as discussed earlier,[87] having the status of an exception creditor does not, by itself, grant the creditor any right to trust distributions. Only those distributions that would otherwise have been made by the trustee (such as a mandatory distribution of income or principal, or a discretionary distribution of income or principal that the trustee has otherwise decided to make) may be the subject of a court order directing them to be paid to the exception creditor. Thus, for example, if the trust is a discretionary trust, and the trustee determines in its discretion not to make a distribution, in most cases a creditor would be unable to force a distribution in satisfaction of its claim.[88] Note also that even with respect to distributions that the trustee either is required to make or has decided in its discretion to make, under section 503(c) a court may limit the amount payable to the creditor, after taking into consideration the circumstances of the beneficiary and the beneficiary's family.[89]

includes a valid spendthrift provision and (ii) the creditor is not excepted from spendthrift protection under section 503(b), a creditor has no right to trust distributions until actually received by the beneficiary. A narrow exception to this rule would apply in the situation in which a trustee is delinquent in making a mandatory distribution, in which case the creditor may be able to recover from the trust directly. *See* UNIF. TRUST CODE § 506.

[86] Of course, states are always free to limit the list of exception creditors, as several have already done. *See, e.g.*, VA. CODE ANN. § 55-545.03.B (2005) (omitting spouses and former spouses); WYO. STAT. ANN. § 4-10-503(b) (2005) (same).

[87] *See supra* notes 52-54 and accompanying text.

[88] There is a narrow exception to this assertion, with respect to claims by children, spouses, and former spouses in cases in which the trustee has failed to comply with a standard for distributions or has abused its discretion with respect to making distributions. *See* UNIF. TRUST CODE § 504(c).

[89] *See id.* § 503 cmt. (discussing subsection (c) and referring to similar authority granted under section 501).

B. *Argument 2: Exception Creditors Are Granted Rights that Are Too Broad, and the List of Exception Creditors Can Readily Be Expanded*

The critics have argued (i) that the remedies available to so-called exception creditors are too broad and (ii) that the list of exception creditors can be expanded too easily. This section of the Article will consider each of these arguments in turn.

First, the critics apparently believe that one's status as an exception creditor means that one will automatically be entitled to recover from the assets of a trust, even if the beneficiary's only interest is discretionary.[90] In fact, however, an exception creditor's remedies are quite limited. Section 503(b) provides that an exception creditor "may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary."[91] Thus, the exception creditor's remedy is to attach the beneficiary's *interest*, not the assets of the trust. Moreover, if the beneficiary's interest is discretionary, except in the rare case in which a child or spouse is able to establish an abuse of discretion under section 504(c), if the trustee in its discretion withholds distributions to the debtor beneficiary, then the creditor will be entitled to nothing.

The critics also apparently believe that a governmental entity, as a potential exception creditor under section 503,[92] will be able to recover as a creditor against a so-called supplemental-needs trust (a trust designed to avoid disqualifying the beneficiary for needs-based government benefits). The critics observe that, under section 503, governmental agencies are no longer automatically considered an exception creditor for purposes of spendthrift protection.[93] Thus, according to the critics:

---

[90] *See* Merric & Oshins, *supra* note 1, at 484 ("While exception creditors had no claim against a discretionary trust under common law, all exception creditors would be allowed to directly attach the assets of a discretionary trust under the UTC . . . ."). This is not, strictly speaking, an accurate description of UTC law. The remedy available to an exception creditor under section 503 is to attach "present or future distribution[,]" not the assets of the trust. UNIF. TRUST CODE § 503(b). If the beneficiary's interest is discretionary, the exception creditor would be entitled to nothing, unless and until the creditor chose to make a distribution.

[91] UNIF. TRUST CODE § 503(b).

[92] Section 503(b)(3) provides that 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." *Id.* § 503(b)(3). Thus, a governmental entity—unlike children, spouses, and former spouses, for example—is not automatically an exception creditor under the UTC; the government becomes an exception creditor only if another state statute or federal law so provides.

[93] *See* Merric & Oshins, *supra* note 1, at 484; *see also supra* note 92 (discussing section 503(b)(3)).

> Once the state governmental agencies realize that they no longer may recover from this type of trust, it may be only a matter of time before the state or federal government is able to convince the state legislators to add them as an exception creditor. At this time [that is, after the state legislators have acted], a state or federal governmental agency would be able to recover from all trusts in a UTC state, including third-party discretionary Medicaid or special needs trusts.[94]

There are several problems with this statement. First, the statement appears to be criticizing the UTC for *failing* to make a governmental entity automatically an exception creditor, because this will prompt governments to change the law so that they *are* automatically considered exception creditors. It is difficult to see how the UTC constitutes a weakening of spendthrift protection, if the UTC removes the government's previously existing right as a creditor. Second, the statement fundamentally misunderstands the relationship between state and federal law. No matter what the UTC says, and no matter how the UTC may subsequently be modified by a state legislature, the federal government is not dependent on state law if it chooses to recover from spendthrift trusts. If the federal government wishes to be treated as an exception creditor, a federal statute or a decision favorable to the government by a federal court will suffice. Third, as discussed in greater detail below,[95] governmental entities that pay out benefits for disabled individuals (i.e., the beneficiary of a supplemental-needs trust) are almost never creditors of the beneficiary during the beneficiary's lifetime. With respect to certain types of supplemental-needs trusts, and under very limited circumstances, the government may seek reimbursement from the trust following the beneficiary's death, but the creditor protection attributes of the trust during the beneficiary's lifetime are irrelevant. Moreover, in most respects the right of a governmental entity to recover from such a trust is dictated by federal law, not state law; thus, in this respect the UTC is irrelevant.

Additionally, the critics are concerned that the list of exception creditors may readily be expanded by a state legislature.[96] According to the critics, "[u]nder the UTC, the state legislature may easily do this statutorily by simply appending an unnoticed exception as part of any other bill that passes through the legislature."[97] In other words, the critics apparently believe that having the UTC on the books will make it

---

[94] Merric & Oshins, *supra* note 1, at 484.

[95] *See infra* notes 155-159 and accompanying text.

[96] *See* Merric & Oshins, *supra* note 1, at 484 (citing, by way of contrast, Mississippi legislation overturning a court decision creating an exception for certain tort creditors).

[97] *Id.*

easier for future legislation on the topic to avoid public scrutiny. It is difficult to understand, however, why a statute modifying section 503 would receive less attention than a statute modifying state common law. Moreover, if recent experience is any guide, any changes to Article Five of the UTC would be hotly debated.

The critics also apparently believe that the list of exception creditors may be judicially expanded.[98] Putting aside the question of why the existence of a codified list of exception creditors (as opposed to a list developed by the common law) would make judicial expansion *more* likely, as opposed to less likely, the critics approach this question with a faulty premise. Article Five of the UTC expressly prohibits creditors from reaching the assets of a beneficiary's interest in a spendthrift trust, "except as otherwise provided in this [article]."[99] Thus, the list of exception creditors in section 503(b) is exhaustive.[100]

The critics are also concerned that section 503 of the UTC provides an opportunity for *all* creditors (not just exception creditors) to reach the assets of a spendthrift trust through bankruptcy proceedings. As explained by Merric and Oshins:

> [W]hat if the federal Bankruptcy Code one day references the UTC exception creditor list? . . . The federal Bankruptcy Code could take advantage of this loophole [the "loophole" being that section 503(c) contemplates the federal or state government granting itself status as an exception creditor] by enacting a statute such as, "[t]he Federal Bankruptcy Trustee is an exception creditor pursuant to section 503(c) of any State that has adopted this provision of the Uniform Trust Code."
>
> All a creditor need do is file an involuntary bankruptcy against the debtor, . . . and the creditor would have easy access to the trust assets. In essence, this would mean all judgment creditors—not just alimony, child support, necessary expenses of the creditor, federal claims, state claims and tort creditors—but anyone who had a debt greater than $11,625 [citing the Bankruptcy Code]. Should federal bankruptcy law ever allow recovery against a trust in a UTC state, *there is virtually no asset protection provided by a spendthrift provision*.[101]

There are several problems with this anticipated parade of horribles. First, section 503(b) contemplates a state statute or a federal

---

[98] *See id.* at 484 ("future exception creditors may now be added both judicially and legislatively").

[99] UNIF. TRUST CODE § 502(c) (alteration in original).

[100] In this respect, the UTC notably differs from the Restatement (Third), which provides that its exceptions from spendthrift protection are "not exclusive" and that "evolving policy may justify recognition of other exceptions." RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a(2) (2003).

[101] Merric & Oshins, *supra* note 1, at 484-85 (emphasis added).

statute or court decision granting *the government* status as an exception creditor. Because the bankruptcy trustee is a fiduciary representing the interests of creditors (which may or may not include governmental creditors), it is not at all obvious that it would qualify as a governmental entity for purposes of section 503(b). Second, the presence or absence of the UTC as state law has no bearing on Congress's ability to include spendthrift trusts as part of the bankruptcy estate—federal law will always preempt state law on such questions, regardless of whether the state law is embodied in the UTC or instead is set forth in a non-UTC statute or state court decision. Moreover, it is absurd to think that Congress would target only jurisdictions that had adopted the UTC for such a rule. Finally, as discussed earlier, having the status of an exception creditor does not guarantee that a creditor will recover from a trust.

C. *Argument 3: Eliminating the Distinction Between Support Trusts and Discretionary Trusts Compromises Protection from Creditors' Claims*

The critics argue that "the UTC . . . abolish[es] the 125-year common law distinction between a discretionary trust and a support trust, so that discretionary trusts must now rely on spendthrift protection for their asset protection value."[102] For a number of reasons, in my view the critics' concerns about this issue are largely unfounded.

Regarding the distinction (and supposed abolition of the distinction) between support trusts and discretionary trusts, some background may be helpful in understanding the critics' concerns. In certain respects the case law concerning the rights of beneficiaries and their creditors has drawn distinctions, though not consistently, between wholly discretionary trusts—trusts in which the beneficiary's interest is described in purely discretionary terms, e.g., that distributions may be made (or withheld) in such amounts and for such purposes as the trustee determines—and so-called support trusts—trusts in which distributions to the beneficiary are made subject to a standard, such as one relating to the beneficiary's health, education, or support. The case law concerning these two categories of trusts often makes the following distinctions. With respect to a discretionary trust, the beneficiary is not entitled to any specific quantity of distributions. Because the beneficiary cannot compel the trustee to make distributions, a creditor of the beneficiary similarly cannot; creditor protection in the case of a discretionary trust

[102] *Malpractice Issues*, *supra* note 16, at 586.

depends not on the validity of a spendthrift provision, but on the nature of the beneficiary's interest.[103] With respect to a support trust, because the trust is established for the express purpose of providing for the beneficiary's support needs, the traditional view is that the beneficiary's interest cannot be alienated and, consequently, most creditors cannot reach the beneficiary's interest, regardless of whether the trust includes a spendthrift provision.[104] On the other hand, there is some authority at common law that a supplier of necessaries (either necessary services or necessary goods)—for example, a physician who has treated the beneficiary—may recover from a support trust,[105] under the theory that, because the beneficiary could enforce the distribution standard, a creditor could also do so, if the payments to the creditor would be consistent with the standard.[106]

In what respects has the UTC eliminated these distinctions, and to what extent does this affect the creditor-protection attributes of trusts? The focus of the critics' concerns about this issue is on section 504 of the UTC, which contains two relevant provisions, subsections (b) and (c). Under section 504(b):

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

---

[103] Professor Scott elaborates on this point as follows:

> Where by the terms of the trust a beneficiary is entitled only to so much of the income or principal as the trustee in his uncontrolled discretion shall see fit to give him, he cannot compel the trustee to pay to him or to apply for his use any part of the trust property. In such a case, an assignee of the interest of the beneficiary cannot compel the trustee to pay any part of the trust property, nor can creditors of the beneficiary reach any part of the trust property. This is true even in jurisdictions where spendthrift trusts are not permitted. If the beneficiary himself cannot compel the trustee to pay over any part of the trust fund, his assignee and his creditors are in no better position. It is the character of the beneficiary's interest, rather than the settlor's intention to impose a restraint on its alienation [by use of a spendthrift provision], which prevents its being reached.

2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 155 (4th ed. 1987).

[104] The point is explained in the Restatement (Second) as follows:

> In a trust for support it is the nature of the beneficiary's interest rather than a provision forbidding alienation which prevents the transfer of the beneficiary's interest. The rule stated in [section 154] is not dependent upon a prohibition of alienation by the settlor; but the transferee or creditor cannot compel the trustee to pay anything to him, because the beneficiary could not compel payment or compel application in any way except for the restricted purpose set out in the terms of the trust.

RESTATEMENT (SECOND) OF TRUSTS § 154 cmt. b (1959).

[105] *Id.* § 157(b) & cmt. c.

[106] *See, e.g.*, *id.* § 157 cmt. c, which elaborates as follows: "If such a claim were not enforced, it would tend to prevent the beneficiary from obtaining necessary services, and refusal to enforce such a claim is not necessary for the protection of the beneficiary's interest under the trust."

> (1) the discretion is expressed in the form of a standard of distribution; or
>
> (2) the trustee has abused the discretion.[107]

According to the official comment, this language "eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories."[108]

There is little, if any, doubt that section 504(b) does not diminish the creditor protection attributes of either discretionary or support trusts. If anything, the statute strengthens creditor protections associated with those trusts in several important respects. First, even a supplier of necessaries cannot compel distributions from a support trust. Second, the statute eliminates any argument that a support interest should be treated as mandatory and thus subject to compelled distributions to certain creditors, who would stand in the beneficiary's shoes. Third, the statute eliminates any argument that a creditor, under some circumstances, might be able to reach a discretionary interest under the theory that a beneficiary could have compelled distributions from a trustee who had inappropriately withheld distributions.[109] Under the statute, even if the trustee has abused its discretion, a creditor has no right to compel distributions to the creditor. This point is confirmed by the comment as follows:

> Eliminating this distinction affects only the rights of creditors. The affect [sic] of this change is limited to the rights of creditors. It does not affect the right of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard.[110]

Thus, the distinction between support and discretionary trusts is eliminated with respect to creditor claims only, not for purposes of determining the rights of beneficiaries.

---

[107] UNIF. TRUST CODE § 504(b) (2005).

[108] *Id.* § 504 cmt.

[109] In this respect, note the difference between the approach of section 504(b) and the approach of the Restatement (Third), which states that

> if the terms of a trust provide for a beneficiary to receive distributions in the trustee's discretion, a . . . creditor of the beneficiary is entitled to receive or attach any distributions the trustee makes or is required to make in the exercise of that discretion.

RESTATEMENT (THIRD) OF TRUSTS § 60 (2003). The comment to the Restatement (Third) indicates that this language is intended to allow a creditor, under certain circumstances, to stand in the beneficiary's shoes and to compel distributions that the beneficiary could compel. *Id.* § 60 cmt. e. By contrast, under section 504(b), a creditor can never compel a distribution. Moreover, even the Restatement (Third) contemplates that a creditor's power to compel distributions will often be more limited than the beneficiary's power to do so. *See* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. e.

[110] UNIF. TRUST CODE § 504(c) cmt..

Under subsection (c):

> To the extent a trustee has not complied with a standard of distribution or has abused a discretion:
>
> (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and
>
> (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.[111]

Again, the comment makes clear that the provision is intended to eliminate any distinctions between discretionary trusts and support trusts, but only with respect to claims of creditors.[112]

Section 504(c) appears to strengthen traditional creditor protection in some respects, and arguably weaken it in others. The provision strengthens creditor protection by expressly providing that a claimant cannot reach the beneficiary's interest unless "the trustee has not complied with a standard of distribution or has abused a discretion."[113] Presumably the burden would be on the claimant to prove that the trustee has so failed to satisfy his obligations. In most cases, proving abuse of discretion would be inordinately difficult; the statute will thus dissuade many such claimants from seeking to recover from trusts. Moreover, a 2005 amendment to the statute makes clear that a trust that includes a support standard will be interpreted as granting the trustee discretion in carrying out its terms.[114] Thus, proving non-compliance with a standard will be comparably difficult in most cases.[115]

---

[111] *Id.* § 504(c).

[112] *Id.* § 504.

[113] *Id.* § 504(c).

[114] Section 506 of the UTC was modified in 2005 to furnish a definition of "mandatory distribution," which, under section 506(b), a creditor can reach if the distribution does not occur within a reasonable time after the designated distribution date. Section 506(a) excludes from the definition of "mandatory distribution" "a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction." *Id.* § 506(a). Thus, the statute contemplates that distributions pursuant to a support standard will be treated as discretionary, not mandatory. This point is bolstered by language in the comment to section 506 as follows: "Under both Sections 504 and 506, a trust is discretionary even if the discretion is expressed in the form of a standard, such as a provision directing a trustee to pay for a beneficiary's support." *Id.* § 506 cmt.

[115] Most trusts establishing a standard for distributions expressly grant the trustee discretion in satisfying that standard. Consider, for example, a trust providing that "the trustee may pay to or for the benefit of Child X as much of the net income or principal of the trust as the trustee may deem necessary for Child X's support and health." Note that distributions from the trust are limited to those necessary for the beneficiary's support or health, but the trust does not mandate that distributions for those purposes must occur—rather, whether and in what amounts to make

Section 504(c) arguably weakens creditor protection—at least in some jurisdictions—by expressly providing that children, spouses, and former spouses with support claims can compel distributions from discretionary trusts under some circumstances. Although there is substantial case law supporting the proposition that a child, spouse, or former spouse may compel distributions from a trust for the support of the beneficiary,[116] there is only modest support for the proposition that such a claimant can compel distributions from a wholly discretionary trust.[117] Thus, states adopting section 504(c) may be changing their law in this respect.[118] Of course, even if a claimant could theoretically recover from a discretionary trust, he or she would still be required to prove that the trustee has abused its discretion in withholding distributions, an inordinately difficult task under most circumstances.

D. *Argument 4: The UTC Grants Enforceable Rights to Beneficiaries Not Held at Common Law*

The critics argue that the UTC gives beneficiaries of discretionary trusts enforceable rights not held at common law and that those enforceable rights undermine the asset-protection attributes traditionally associated with discretionary trusts. The gist of the critics' argument is that the creditor protection attributes of discretionary trusts depend on a creditor standing in the shoes of the beneficiary—if the beneficiary has no enforceable rights to trust distributions, then a creditor of the beneficiary similarly does not. In the critics' view, the UTC grants beneficiaries of discretionary trusts greater rights than they held at common law because the UTC requires the trustee to exercise its

such distributions is left to the discretion of the trustee. Moreover, defining what amounts are necessary for the beneficiary's support and health are expressly made subject to the trustee's discretion. In such a case, a claimant under section 504(c) would have to overcome two significant obstacles to force a distribution from the trust. First, the claimant would have to demonstrate a failure to comply with the standard—an especially difficult task, considering that the standard itself is within the trustee's discretion. Second, to the extent that the trustee withholds distributions, the claimant would have to demonstrate abuse of discretion, a daunting task under any circumstances.

[116] *See* RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. b (1959); *see generally* SCOTT & FRATCHER, *supra* note 103, at § 157.1 (collecting and discussing various cases).

[117] *See* RESTATEMENT (SECOND) OF TRUSTS § 155(1); *see also* Carolyn L. Dessin, *Feed a Trust and Starve a Child: The Effectiveness of Trust Protective Techniques Against Claims for Support and Alimony*, 10 GA. ST. U. L. REV. 691, 707-14 (1994) (discussing various cases).

[118] Whether this is appropriate as a matter of public policy is a question to which each adopting state is free to reach its own conclusion. Thus, for example, several states have enacted a modified version of section 504(c), so that the rule applies only to support claims by children (and not by spouses or former spouses). *See, e.g.*, VA. CODE ANN § 55-545.04.C (2005).

discretion in "good faith."[119] Apparently, the critics believe that the common law does not impose a good faith standard on trustees. For a number reasons, in my view, the critics' concerns about the effects of the UTC "good faith" standard are similarly not well founded.

The first and most important problem with the critics' concerns is that, in virtually all circumstances under the UTC, whether a beneficiary has the power to compel discretionary distributions is irrelevant in determining the rights of the beneficiary's creditors. Almost all trusts include spendthrift provisions and, under the UTC—except in the case of exception creditors, such as a child or spouse to whom the beneficiary owes a support obligation—a creditor cannot reach the assets of a spendthrift trust or a beneficiary's interest in a spendthrift trust prior to the beneficiary's receipt of a distribution. Moreover, section 504(b) of the UTC prohibits creditors (other than a select list of creditors with specific types of claims) from compelling distributions, regardless of whether the beneficiary would have the power to do so. Thus, in most situations, whether the beneficiary could compel discretionary distributions would have no bearing on a creditor's ability to satisfy its claim.

In support of their position the critics cite to section 504(d) of the UTC, which states that section 504—which prohibits creditors in most cases from compelling discretionary distributions—"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."[120] This language, the critics claim, grants beneficiaries a right to compel distributions, a right not held at common law. But section 504(d) does not grant beneficiaries any rights at all; rather, subsection (d) expressly provides that section 504 *does not limit* the right of a beneficiary to maintain an action against a trustee. Not limiting the right is not the equivalent of granting a right. Moreover, the comment to section 504 makes clear that any right a beneficiary may have to compel distributions would be governed by section 814, not section 504.[121]

The focus of the critics' concerns is on section 814(a) of the UTC, under which a trustee is required to exercise discretionary powers "in

---

[119] UNIF. TRUST CODE § 814(a).

[120] *Id.* § 504 (d).

[121] *Id.* § 504 cmt. The comment states that the elimination in section 504 of the distinction between support trusts and discretionary trusts

> does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. *See* Section 814 comment.

Id.

good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries,"[122] even if the trust instrument grants the trustee so-called extended discretion (by expressing that discretion with terms such as "absolute," "sole," or "uncontrolled"). According to the critics, at common law a trustee who is granted extended discretion has no obligation to act in good faith. In support of their position, the critics cite to authority that prohibits trustees from acting in bad faith,[123] which, the critics claim, is fundamentally different from the good faith standard imposed by section 814. The critics also apparently claim that the "good faith" standard under section 814 requires a trustee to act "reasonably," which at common law, the critics claim, a trustee is not required to do.[124] Finally, at least one commentator has questioned whether the requirement in section 814(a) that the trustee act "in accordance with the terms and purposes of the trust and the interests of the beneficiaries"[125] may enhance a beneficiary's ability to challenge a trustee's exercise of discretion.[126]

---

[122] *Id*. § 814(a).

[123] Merric and Oshins view the bad faith standard as exemplified by the standard described in a recent Colorado Supreme Court opinion. *See* Merric & Oshins, *supra* note 1, at 479 n.1. In *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991), the Colorado Supreme Court, in an en banc decision, stated that, "*[i]f the settlor manifested an intention that the discretion of the trustee should be uncontrolled, the court will not interfere unless he acts dishonestly or from an improper motive, or fails to use his judgment*." *Id.* at 1156 (emphasis added) (citing SCOTT & FRATCHER, *supra* note 103, § 128.3). Putting aside the question whether the standard stated in *Jones* is different from the standard stated in section 814, in several respects the critics' reliance on *Jones* is problematic. *See* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP., PROB. & TR. J. 567, 607-08 n.210 (2005). In the first place, *Jones* did not purport to establish a single standard for reviewing a trustee's exercise of discretion. *Id.* (noting at least four different statements in *Jones* concerning the appropriate standard of review). Second, *Jones* did not involve a challenge to a trustee's exercise of discretion; rather, the court was concerned with whether a beneficiary's interest in a discretionary trust constituted property for purposes of a divorce settlement. *Id.* Also, it is noteworthy that, only one year after the Supreme Court's decision in *Jones*, an immediate appellate court in Colorado, in a case involving a challenge to a trustee's exercise of discretion, approved the trial court's finding that the trustee's conduct constituted a "breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward the beneficiary," notwithstanding that the trust instrument granted the trustee "sole" and "absolute" discretion. *In re* Estate of McCart, 847 P.2d 184, 186 (Colo. Ct. App. 1992).

[124] *See* Merric & Oshins, *supra* note 1, at 481 (comparing language in the UTC and the Restatement (Third)).

[125] UNIF. TRUST CODE §814(a).

[126] *See* U.S. TRUST, PRACTICAL DRAFTING 7440 (2003). As stated in *Practical Drafting*:

> Section 814(a) illustrates the uncertainty that codifying the trust law may create. What do the words "and in accordance with the terms and purposes of the trust and the interests of the beneficiaries" mean? Do they create a stricter limit on the discretion that may be conferred upon a trustee than the common law test set forth in the above quotation from Scott [see below]? It seems likely that courts will use them to do so in particular cases, yet their application to particular facts remains as hard to predict as that of the common law. Has anything been gained by codification?

Id. The reference to the "Scott" quotation is to the following:

For several reasons, in my view section 814(a) does not grant beneficiaries greater rights to challenge trustees' decisions than those granted at common law.

Implicit in the critics' argument is the assertion that, by granting a trustee extended discretion, the trustee's exercise of that discretion becomes essentially unreviewable. But this has never been true at common law. An essential principle of the common law of trusts is that a trustee's exercise of discretion is always subject to judicial review, no matter how broadly the trustee's discretion may be described.[127] Thus, even if the trust instrument grants the trustee extended discretion, that will not be interpreted so as to relieve the trustee from an obligation to account for its discretionary judgments.[128] Because a trustee is a fiduciary, it would be inconsistent with the concept of a trust to insulate a trustee's exercise of discretion from all judicial review.[129] Moreover, as a fiduciary, a trustee owes a duty of impartiality to the beneficiaries.[130] Thus, a trustee could be subject to liability for favoring

> The extent of the discretion may be enlarged by the use of qualifying adjectives or phrases such as "absolute" or "uncontrolled." Even the use of such terms, however, does not give him unlimited discretion. A good deal depends upon whether there is any standard by which the trustee's conduct can be judged. Thus if he is directed to pay as much of the income and principal as is necessary for the support of a beneficiary, he can be compelled to pay at least the minimum amount which in the opinion of a reasonable man would be necessary. If, on the other hand, he is to pay a part of the principal to a beneficiary entitled to the income, if in his discretion he should deem it wise, the trustee's decision would normally be final, although as will be seen the court will control his action where he acts in bad faith. The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he should act.

Id. at 7439 (quoting 3 SCOTT & FRATCHER, *supra* note 103, § 187).

[127] *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (2003); RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. k (1959); GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 560, at 211-12 (rev. 2d ed. 1980). As stated in the Restatement (Second):

> The settlor cannot confer upon the trustee such an unlimited power that the court will not entertain a suit by the beneficiary to prevent the trustee from acting dishonestly. It is against public policy to permit the settlor to relieve the trustee of all accountability. It is true that the powers conferred upon the transferee of property may be so extensive as to indicate an intention not to create a trust but to give the beneficial interest in the property to the transferee. If, however, a trust is created, it is required by public policy that the trustee should be answerable to the courts, so far at least as the honesty of his conduct is concerned.

RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. k (internal citations omitted).

[128] *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c; 3 SCOTT & FRATCHER, *supra* note 103, § 187, at 15.

[129] *See* WILLIAM M. MCGOVERN, JR. & SHELDON F. KURTZ, WILLS, TRUSTS AND ESTATES § 9.5, at 340 (3d ed. 2004) (observing that a "trustee" who is not subject to account makes no sense, because a trust connotes some control over the trustee); RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (stating that it is "a contradiction in terms . . . to permit the settlor to relieve a 'trustee' of all accountability").

[130] RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. b; *see also* UNIF. TRUST CODE § 803 (2000)

one beneficiary (a remainder beneficiary, for example) over another (for example, a beneficiary requesting a current discretionary distribution).

The critics place too much emphasis on the language in some cases indicating that a trustee may not act in "bad faith." Court decisions vary considerably in their formulations of the standards of conduct for trustees; the formulations differ from case to case not so much because courts intend to express substantively different standards, but rather because the facts of a specific controversy cause one court to emphasize certain aspects of the standard over others. As an example of expressing the same standard using different words, consider the following passages from Professor Scott's treatise, in which he considers the standard applicable to a trustee whom the settlor has purportedly relieved of the requirement of reasonableness:[131]

> In such a case the exercise by the trustee of his discretion will not be interfered with by the court, even though he acts beyond the bounds of a reasonable judgment, if he acts *in good faith* and does not act capriciously.[132]

A later passage in the same section of the treatise expresses the standard as follows:

> Even 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 with an improper motive.[133]

Professor Scott apparently views these formulations as interchangeable; there is no suggestion in the treatise that they should be viewed as substantively different.[134]

(stating that, "[i]f a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests").

[131] As to whether a reasonableness standard applies to trustees or may be dispensed with, consider the discussion *infra* notes 142-144 and accompanying text.

[132] 3 SCOTT & FRATCHER, supra note 103, § 187.2, at 38 (emphasis added).

[133] *Id.* § 187.2, at 39 (emphasis added).

[134] *See id.* § 187.2; *see also* Newman, supra note 123, at 605 (discussing this point). The comment to UTC § 814 further emphasizes this point:

> The obligation of a trustee to act in good faith is a fundamental concept of fiduciary law although there are different ways that it can be expressed. Sometimes different formulations appear in the same source. Scott, in his treatise on trusts, states that the court *will not* interfere with the trustee's exercise of discretion if the trustee "acts in good faith and does not act capriciously," but Scott then states that the trustee *will* interfere if the trustee "acts dishonestly or in good faith, or where he acts from an improper motive." 3 Austin W. Scott & William F. Fratcher, The Law of Trusts Section 187.2 (4th ed. 1988).
>
> Sometimes different formulations are used in the same case:
>
> [If] the "sole discretion" vested in and exercised by the trustees in this case . . . were exercised fraudulently, in bad faith or in an abuse of discretion, it is

The critics' assertion that a standard requiring "good faith" is different from—and, more specifically, is more onerous than—a standard prohibiting "bad faith" has no basis in the law. A recent article by Professor Newman considers this issue directly:

> Is the requirement of subsection 814(a) that the trustee act in good faith, regardless of the extent of discretion the settlor grants the trustee, a change from the common law?
>
> No. Cases from many jurisdictions explicitly acknowledge the requirement that trustees exercise discretion in good faith even if the trustee is granted extended discretion. Many other cases, however, do not explicitly acknowledge the trustee's duty to act in good faith, but instead provide that the trustee's exercise of its discretion will not be disturbed absent one or more of factors such as bad faith, dishonesty, an improper motive, or a failure to use the trustee's judgment. The fact that these cases do not explicitly state that trustees must act in good faith, regardless of the breadth of their discretion, however, does not mean that the courts that decided them do not require good faith of the trustee.
>
> Rather, requiring that the trustee not act in bad faith, or dishonestly, or with an improper motive, or fail to act altogether is another way of expressing the fundamental fiduciary requirement that the trustee must act in good faith (or implicitly includes that requirement). There is much evidence that is the case.[135]

Professor Newman examines numerous cases from around the country as well as other authorities and concludes that there is no support for the notion that the two standards are substantively different.[136] To view the two standards as substantively different is nonsensical—if absence of "bad faith" means something other than "good faith," what would that be? Just to ask the question demonstrates the absurdity of the critics' position—a fiduciary (or any person, for that matter) acts either in good faith or not.

More fundamentally, the critics' contention that at common law a trustee granted extended discretion is not required to act in "good faith" is simply wrong. The critics can point to no authority to that effect, and for good reason, there simply is none. Professor Newman is able to identify only one court stating that a trustee need not act in good faith, but the statement constitutes dictum and, upon closer analysis, it is

---

> subject to . . . review. Whether good faith has been exercised, or whether fraud, bad faith or an abuse of discretion has been committed is always subject to consideration by the court upon appropriate allegations and proof.

In re Ferrall's Estate, 258 P.2d 1009 (Cal. 1953).

UNIF. TRUST CODE § 814 cmt. (2005) (alterations in orginal).

135 Newman, *supra* note 123, at 605-06 (citations omitted).

136 *See id.* at 605-09.

apparent that the court was confusing the good faith standard with the requirement that the trustee act reasonably.[137] There are no cases holding that a settlor may relieve a trustee from the duty to act in good faith, for obvious reasons—to do so would be patently in conflict with all notions of the standards of behavior expected from fiduciaries.

The question whether the UTC's "good faith" standard also requires a trustee to act reasonably implicates the more general question as to whether the common law of trusts imposes a reasonableness requirement on trustees. Putting aside section 814(a) for the moment, is there a requirement at common law that a trustee act reasonably? The authorities on this question are not consistent. Under the Restatement (Second) of Trusts, "[i]f there is a standard by which the reasonableness of the trustee's judgment can be tested, the court will control the trustee in the exercise of a power where he acts beyond the bounds of a reasonable judgment, unless it is otherwise provided by the terms of the trust."[138] The Restatement (Second) further states that, if the nature of the power conferred on the trustee is "such that there is no standard indicated by the terms of the trust by which the reasonableness of his conduct in exercising or failing to exercise the power can be judged. . . . [T]he court will interpose if the trustee acts dishonestly, or from some improper motive."[139] The Restatement (Second) further provides that the use of extended discretion language is "not [to be] interpreted literally but [is] ordinarily construed as merely dispensing with the standard of reasonableness."[140] The Restatement (Third), in contrast, observes that cases are difficult to find in which extended discretionary language has been construed to excuse unreasonable conduct.[141] As discussed further below, the better view is that the

[137] *See id.* at 609. In *Krug v. Krug*, 838 S.W.2d 197 (Tenn. Ct. App. 1993), a trustee was given the "sole discretion" to remove and replace a cotrustee. According to the court, notwithstanding the use of the phrase "sole discretion," the trustee was required to exercise his removal power in "good faith." *Id.* at 201. The court stated in dictum that, had the trust instrument had used language such as "absolute," "unlimited," or "uncontrolled" discretion, under those circumstances the trustee would not be required to act in good faith. *Id.* As pointed out by Professor Newman, however, the dictum "appears to be based on the court's mistaken treatment of the trustee's obligation to act in good faith as the obligation to act reasonably." Newman, *supra* note 123, at 609.

[138] RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. i (1959).

[139] *Id.* § 187 cmt. i. illus. 12.

[140] *Id.* § 187 cmt. j. The comment further states that, "[i]n such a case the mere fact that the trustee has acted beyond the bounds of a reasonable judgment is not a sufficient ground for interposition by the court." *Id.* Note that the Restatement demands reasonable conduct of a trustee if the discretionary grant of authority does not include language such as "absolute" or "unlimited." *See id.* § 187 cmt. e (stating that, under these circumstance, a court will interfere with a trustee's exercise of power if the trustee "acts beyond the bounds of a reasonable judgment"); *see also* 3 SCOTT & FRATCHER, *supra* note 103, § 187, at 14-15 (same).

[141] RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (2003): *see also* BOGERT & BOGERT, *supra* note 127, § 560, at 217-18 ("The authorities do not appear to support the Restatement [Second]

trustee's conduct must always be reasonable, regardless of the breadth of discretion granted.[142]

As to whether the UTC incorporates the distinctions drawn by the Restatement (Second), consider the following passage from the comment to section 814, as amended in 2005:

> Subsection (a) requires a trustee exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to Restatement (Second) of Trusts Section 187 (1959), subsection (a) does not impose an obligation that a trustee's decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee's judgment can be tested. Restatement (Second) of Trusts Section 187 cmt. f (1959).[143]

Notably, the comment refers to the distinction in the Restatement (Second) between discretion subject to a standard and discretion in the absence of a standard, as described above,[144] but it does not refer to the earlier described distinction between ordinary discretion and extended discretion.[145] By not addressing this question, the UTC may simply be leaving the matter to the common law.[146]

Finally, does the requirement in section 814(a) that a trustee exercise extended discretionary powers "in accordance with the terms and purposes of the trust and the interests of the beneficiaries"[147] subject a trustee to a higher level of scrutiny than at common law? Numerous cases and other authorities confirm that, notwithstanding broad grants of discretion to a trustee, a trustee nevertheless must act in a manner consistent with the terms and purposes of the trust.[148] The expression "interests of the beneficiaries" is defined in section 103(8) of the UTC:

---

position that there is no requirement of reasonableness in the exercise of a power granted in the trustee's absolute discretion.").

142 *See infra* notes 199-206 and accompanying text.

143 UNIF. TRUST CODE § 814 cmt. (2005).

144 *See supra* notes 139-141 and accompanying text. According to the Restatement (Second), a reasonableness requirement is imposed only if there is a standard against which it can be measured.

145 *See supra* note 141 and accompanying text. According to the Restatement (Second), the use of extended discretion dispenses with the reasonableness requirement.

146 *See* Newman, *supra* note 123, at 610-11. Professor Newman cites to UTC § 106, which provides that "[t]he common law of trusts and principles of equity supplement this [Code], except to the extent modified by this [Code] or another statute of this State." UNIF. TRUST Code §106(a) (first alteration added). Thus, to the extent section 814 is silent concerning this question, a court would be bound by precedent or free to devise its own rule.

147 UNIF. TRUST CODE § 814(a).

148 *See* RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. j (1959) (stating that a trustee granted extended discretion may not exercise its discretion "from some motive other than the accomplishment of the purposes of the trust"); *see also* Newman, *supra* note 123, at 614 & n.239 (citing cases).

it simply means "the beneficial interests provided in the terms of the trust."[149] As stated in the comment to section 103, the "definition clarifies that the interests are as provided in the terms of the trust and *not as determined by the beneficiaries*."[150] This explanation should be sufficient to counter any suggestion that section 814(a) enhances the power of any particular beneficiary to demand discretionary distributions from a trustee.

E. *Argument 5: The UTC Compromises the Effectiveness of Supplemental-Needs Trusts*

The critics argue that the UTC will undermine the effectiveness of so-called supplemental needs trusts—trusts intended to allow their beneficiaries to qualify for needs-based governmental benefits. The critics' arguments concerning this issue may be summarized as follows:

> With respect to Medicaid or special needs trusts, the UTC . . . create[s] two major concerns. First, will a federal government or state government be able to attach the beneficial interest? Second, will the Medicaid or special needs trust be considered an available resource of the beneficiary?
>
> For states that adopt the UTC, it may be only a short time before third-party Medicaid or special needs trust planning is greatly curtailed and eventually eliminated. If the discretionary trust and support trust distinction no longer exists, the federal government or state legislature can pierce any trust by enacting a statute saying that the government may attach the beneficiary's interest and reach some or all of the trust assets.
>
> In states that do not follow the UTC . . . , an interest in a discretionary trust is not a property interest (i.e., an enforceable right). Both Medicaid trust and special needs trust planning depend on the dichotomy between discretionary and support trusts related to this property issue. Regarding the second issue, if a beneficiary has an enforceable right to a distribution, the federal or state government need not necessarily attach a beneficiary's interest. The federal or state government may merely consider the trust as an 'available resource' and deny benefits.[151]

Thus, the gist of the critics' arguments is (i) that the federal or state government, as a creditor, may be able to attach the assets of a supplemental needs trust or the interest of the beneficiary, and (ii) that

---

149 UNIF. TRUST CODE § 103(8).
150 *Id.* § 103 cmt. (emphasis added).
151 Merric & Oshins, *supra* note 1, at 486 (footnotes omitted).

the UTC grants beneficiaries enforceable rights that will cause the trust assets to be treated as a resource of the beneficiary for purposes of qualifying for benefits. In my view, for a number of reasons the critics' assertions concerning these issues are fundamentally flawed.

Some background about supplemental needs trusts may be helpful in understanding these issues. A supplemental needs trust is designed to prevent the trust assets from being treated as a resource of the beneficiary for purposes of determining eligibility for needs-based governmental benefits. The term "supplemental needs" refers to the fact that typically such trusts are structured to provide for needs of the beneficiary that are supplemental to the needs of the beneficiary provided for by the government. There are two general types of supplemental needs trusts: (i) self-settled trusts, i.e., trusts for the benefit of the settlor, which are designed to avoid disqualifying the settlor for governmental benefits and (ii) third-party trusts, i.e., trusts for the benefit of someone other than the settlor, designed to avoid disqualifying the beneficiary for benefits. Self-settled supplemental needs trusts are subject to federal law, enacted as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA), under which a trust that satisfies the OBRA requirements enables assets to be held for a disabled settlor's benefit without disqualifying the settlor for public benefits.[152] A self-settled supplemental needs trust is effective for its intended purpose only if it is drafted in accordance with the OBRA requirements.[153] The UTC will have no bearing on the effectiveness of these trusts under federal law.[154] Whether the UTC will compromise the effectiveness of third-party supplemental needs trusts is a more difficult question, but, again, in my view, the concerns of the critics are unfounded.

As illustrated by the earlier quoted materials,[155] the first issue raised by the critics is that the federal or state government may attach the assets of a supplemental needs trusts or the beneficiary's interest in such a trust. The critics' concerns about this question reflect some fundamental misunderstandings about the law governing public benefits and supplemental needs trusts. The most commonly encountered public assistance programs are Social Security Disability Income, Supplemental Security Income, Medicare, and Medicaid. With respect to Social Security Disability Income, Supplemental Security Income, and Medicare, there are no circumstances under which a governmental

[152] *See generally* CLIFTON B. KRUSE, JR., THIRD-PARTY AND SELF-CREATED TRUSTS: PLANNING FOR THE ELDERLY AND DISABLED CLIENT 11-13 (3d ed. 2002).

[153] *See id.*

[154] *See* Newman, *supra* note 123, at 619.

[155] *See supra* note 151 and accompanying text.

entity would become a creditor of a trust beneficiary, unless benefits were paid in error.[156] With respect to Medicaid, federal law mandates the recovery of certain benefits following the recipient's death and, except in the case of certain real property owned by a permanently institutionalized individual,[157] there is no right for the federal government or a state government to attach the assets of the recipient during the recipient's lifetime.[158] If the supplemental needs trust is self-settled, then federal law mandates reimbursement of any benefits paid during the beneficiary's lifetime; under these circumstances, the UTC would simply be irrelevant. If, instead, the trust is a third-party supplemental needs trust, in most cases the trust assets would not fit the definition of the "recovery estate," as defined by state legislation implementing the Medicaid benefits scheme. As long as the beneficiary's right to receive distributions is subject to the trustee's discretion, the trust should not form part of the beneficiary's recovery estate and thus would not be available for reimbursement of any benefits paid during the beneficiary's lifetime.[159]

The second issue raised by the critics is that the UTC will cause a beneficiary's interest in a third-party supplemental needs trust to be considered an available resource for purposes of qualifying for public assistance. Although this is a more legitimate concern than the critics' concern about the government as a creditor, in my view, once again, the concern is unfounded.

Again, some background may be helpful in understanding the issue. As a general rule, public assistance is limited to those with very limited income and other assets. If the assets of a supplemental needs trust were treated as an asset of the beneficiary, he or she would likely not qualify for most public assistance. The most important of the needs-based public assistance programs is Medicaid, under which assets held in trust will be treated as a resource of the beneficiary only if the beneficiary has the ability to compel distributions for his or her support.[160] Thus, the effect that the UTC has on a beneficiary's eligibility for Medicaid depends on the extent to which the UTC enhances a beneficiary's ability to compel distributions.

Many supplemental needs trusts are drafted specifically to enable the beneficiary to qualify for Medicaid or other public assistance and to provide the beneficiary with amounts other than for the beneficiary's

---

156 *See* Richard E. Davis & Stanley C. Kent, *The Impact of the Uniform Trust Code on Special Needs Trusts*, 1 NAELA J. 235, 237 (2005).

157 Moreover, a residence owned by a supplemental needs trust would not be considered to be owned by the beneficiary for purposes of these rules. *See id.* at 238-39.

158 *See id.* at 238.

159 *See id.* at 239.

160 *See* KRUSE, *supra* note 152, at 52-54.

basic support. Such a trust would typically preclude the trustee from making distributions for the beneficiary's basic support needs and authorize the trustee to make distributions for the beneficiary's *supplemental* needs—that is, to make distributions for non-essentials such as travel, vacations, cultural activities, private (as opposed to shared) institutional housing, elective medical care, etc. There is substantial and consistent case law holding that the assets of such trusts are not considered available resources for Medicaid qualification purposes; moreover, the result is codified by statute in many jurisdictions.[161] The UTC will have no effect on the continued effectiveness of such trusts for this purpose. Under section 814(a), the trustee is required to carry out the terms of the trust in good faith; if the trust terms prohibit distributions for the beneficiary's basic support needs, the UTC will require adherence to this prohibition.

Next, consider a trust expressly intended to be a supplemental needs trust. To what extent will such a trust be considered an available resource for Medicaid purposes, and what effect, if any, will the UTC have on that result? In general, a trust under which the trustee is required to make distribution for the beneficiary's basic support needs *will* be considered an available resource for Medicaid qualification purposes.[162] The UTC will have no bearing on the treatment of such trusts. On the other hand, in general a wholly discretionary trust without a support standard *will not* be considered an available resource for Medicaid purposes.[163] As discussed earlier, the UTC should not enhance a beneficiary's ability to compel distributions from such trusts; thus the UTC should not adversely affect the effectiveness of wholly discretionary trusts for purposes of Medicaid qualification.

A more difficult issue is the Medicaid treatment of third-party trusts in which the trustee is granted discretion in making distributions for the beneficiary's support. Putting aside the effect that the UTC may have on this question, the case law concerning such trusts is inconsistent, with some cases holding that the trust assets are an available resource for Medicaid qualification purposes, and others holding that they are not.[164] The cases turn on the court's interpretation of the settlor's intent and thus the outcome of any particular case is largely fact-driven. The UTC should have little, if any, effect on the outcome of these cases, although for several reasons it may help somewhat for those seeking to qualify for public assistance. First, as

[161] *See id.* at 70-78 (discussing cases); 78-82 (discussing statutes).
[162] *See id.* at 51-52.
[163] *See id.* at 53.
[164] *See id.* at 54-70 (discussing the issue generally); *id.* at 117-28 (tabular summary of significant cases).

earlier discussed, the UTC treats support trusts as discretionary,[165] thereby limiting a beneficiary's ability to compel distributions. Second, under a 2005 amendment, the comment to section 814 cites with approval language from the Restatement (Third) to the effect that, in exercising its discretion, a trustee should do so in a manner that avoids disqualifying the beneficiary for public benefits.[166] In a borderline case, the comment to section 814 may help produce a favorable interpretation of the language of a discretionary trust that also includes a support standard.

F. *Argument 6: The UTC Increases the Exposure of Trust Assets in Divorce Proceedings*

The UTC critics claim that the statute will have a multitude of adverse consequences for beneficiaries who divorce.[167] Among the critics' claims are: (i) that the UTC enhances the ability of a former spouse to reach the assets of a trust for purposes of satisfying an alimony claim; (ii) that the UTC will cause a beneficiary's interest in a trust to constitute a divisible asset for equitable distribution purposes; and (iii) that the UTC will allow courts to consider a beneficiary's interest in a trust for purposes of making alimony or child support awards.[168] These claims reflect a misunderstanding of both domestic relations law and the UTC.

With respect to the first claim, whether the UTC enhances the ability of a former spouse to satisfy an alimony claim depends entirely on whether a former spouse had that ability under the pre-UTC law of an adopting state. In many jurisdictions, the common law already establishes a former spouse with an alimony claims as an exception creditor; thus, in these jurisdictions the UTC would effect no change in

---

[165] This point is made clear in the 2005 amendments to the comments to section 506 of the UTC. *See supra* note 69 and accompanying text.

[166] The full text of the comment is as follows:

> [W]hether the trustee has a duty in a given situation to make a distribution depends on the exact language used, whether the standard grants discretion and its breadth, whether this discretion is coupled with a standard, whether the beneficiary has other available resurces [sic], and, more broadly, the overriding purposes of the trust. For example, distilling the results of scores of cases, the Restatement (Third) of Trusts concludes that there is a presumption that the "trustee's discretion should be exercised in a manner that will avoid either disqualifying the beneficiary for other benefits or expending trust funds for purposes for which public funds would otherwise be available." Restatement (Third) of Trusts Section 50 cmt. e & Reporter's Notes (Tentative Draft No. 2, 1999).

UNIF. TRUST CODE § 814 cmt. (2005).

[167] *A Divorce Attorney's Dream*, *supra* note 16.

[168] *See generally id.* at 45-50.

the law. In those jurisdictions in which a former spouse with an alimony claim is not an exception creditor, the jurisdiction is free to modify the UTC, as has occurred already in several enacting jurisdictions. As observed earlier, the UTC may modestly enhance a former spouse's ability to compel discretionary distributions in some jurisdictions, although the former spouse would need to prove that the trustee had abused its discretion, a daunting task under most circumstances. Moreover, an enacting jurisdiction is again free to modify the UTC in this respect, as several jurisdictions have already done.

With respect to the second claim, the UTC should have little or no effect on whether a beneficiary's interest in a trust constitutes a divisible asset. In most cases, such a trust would be considered separate property of the beneficiary and thus would not be subject to equitable distribution. If the trust is in a jurisdiction in which separate property, in general, is subject to equitable distribution, whether the specific trust in question would be subject to division would depend on a multitude of factors, none of which would be affected to any significant extent by the UTC.[169] The critics claim that a beneficiary's discretionary interest in a trust is more likely to be subject to equitable division under the UTC, because, as the critics claim, the beneficiary will have an enhanced ability to compel distributions. As discussed earlier, in my view there is no support whatsoever for the view that the UTC enhances a beneficiary's ability to compel discretionary distributions.[170] The critics also claim that, even if a beneficiary's interest in a trust is not itself subject to equitable division, in a UTC jurisdiction a court will be more likely to take the beneficiary's interest into account, as the court considers generally the beneficiary's economic circumstances. This claim, too, is founded on the notion that the UTC enhances a beneficiary's ability to compel distributions from discretionary trusts, a notion earlier discredited.

Finally, the critics claim that, in evaluating a beneficiary's economic circumstances for purposes of making alimony and child

---

[169] The factors are summarized by Professor Newman as follows:

> (1) whether the beneficiary's interest is in a trust created by another that is revocable by its still living settlor; (2) whether the beneficiary's interest is vested; (3) whether the beneficiary's interest may be defeated by another's exercise of a power of appointment; (4) whether the beneficiary's interest may be eliminated by discretionary distributions to another beneficiary, or by another beneficiary's power to invade principal; (5) whether the beneficiary's interest is a remainder; (6) whether the beneficiary's interest is an income interest; or (7) whether the beneficiary's interest is subject to the discretion of the trustee and thus is treated as an expectancy, rather than as divisible property.

Newman, *supra* note 123, at 627-29 (citations omitted).

[170] *See supra* Section III.D.

support awards, a court in a UTC jurisdiction will impute trust assets and trust income to the beneficiary of a discretionary trust. This claim, too, is based on the unsupported claim that the UTC enhances a beneficiary's ability to compel discretionary distributions.[171] As discussed elsewhere, there is no substantial support for the critics' position concerning this question.

G. *Argument 7: Drafting a Trust in a UTC Jurisdiction Constitutes Malpractice*

The critics have also argued that drafting a trust in a UTC jurisdiction may expose the lawyer to a malpractice claim for failing to advise his or her client of the increased exposure to creditors' claims caused by the UTC. The critics analogize this situation to that of a lawyer who fails to advise his or her client of the advantages of establishing a trust in a jurisdiction with no state income tax on accumulated trust income.[172] According to the critics, a lawyer's failure to disclose to his or her client the "potential decrease in asset protection available to beneficiaries" in UTC jurisdictions[173] raises malpractice

[171] In support of their position, the critics cite to a recent Massachusetts case, *Dwight v. Dwight*, 756 N.E.2d 17 (Mass. App. Ct. 2001), although they fundamentally misstate both the holding and the reasoning of the case. *See* Merric & Oshins, *supra* note 1, at 487. *Dwight* does not, as the critics claim, *see A Divorce Attorney's Dream*, *supra* note 16, at 50, stand for the proposition that the income earned in a discretionary trust will be imputed to a beneficiary for purposes of making an alimony award. *Dwight* involved a separation agreement, which authorized the wife to bring a claim for alimony if the husband received a substantial inheritance. The husband's father died, leaving a portion of his estate in a discretionary support trust for the husband and his descendants. The court of appeals affirmed the trial court's determination that the trust constituted a substantial inheritance for purposes of the separation agreement. 756 N.E.2d at 20-21. The court of appeals also affirmed the trial court's finding that the trust increased the husband's income, although this finding was based on highly specific factual circumstances, including the fact that the husband had told the trustee that he did not want to receive distributions that the trustee otherwise was inclined to make. Notably, the case did not arise under the UTC. The critics acknowledge this to be true, but claim that "the opinion cited the Restatement Third . . . as authority for dismissing the son's claim" "that he had no enforceable right to a distribution." Merric & Oshins, *supra* note 1, at 487. (The critics view the approaches of the UTC and the Restatement (Third) as equivalent with respect to a beneficiary's right to compel distributions from a discretionary trust. *See id.* at 478-79, 481.) In fact, however, the *Dwight* court's citation to the Restatement (Third) had nothing to do with the question whether the husband could compel distributions to himself; rather, the Restatement (Third) was cited in a footnote, concerning an issue that the court of appeals determined that it did not need to address. 756 N.E.2d at 20 n.3.

[172] *See Malpractice Issues*, *supra* note 16, at 592. The question whether the failure to advise a client to establish a trust in a no-income tax jurisdiction constitutes malpractice is discussed in Michael J. Myers & Rollyn H. Samp, *South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" at Its Incipient Stage?*, 44 S.D. L. REV. 662, 671-79 (1998-1999).

[173] *Malpractice Issues*, *supra* note 16, at 586.

concerns.[174] The gist of the critics' argument is, of course, dependent on their position that the UTC dramatically decreases the asset protection attributes of trusts, a position without substantial support. For this reason, in my view the critics' concerns about the malpractice question are misplaced.

H. *Argument 8: The UTC is a "Regressive" Statute*

The most persistent of the critics, Mark Merric, has argued that the UTC is a "regressive" statute;[175] he compares the UTC with the trust laws of Alaska, Delaware, Nevada, Rhode Island, and Utah, which, he claims, are "considered by most estate planning professionals to be *progressive* trust statutes."[176] Thus, the apparent meaning of "regressive" is "unlike the laws in Alaska, Delaware, Nevada, Rhode Island, and Utah." The common characteristic of the trust laws in those jurisdictions is that they expressly authorize the establishment of so-called asset protection trusts—irrevocable trusts in which the settlor retains a beneficial interest, designed specifically to shelter the assets of the settlor from the claims of his or her creditors.[177] As discussed earlier, the UTC follows the traditional approach by providing that a creditor of the settlor of an irrevocable trust can reach the maximum amount that can be distributed to the creditor.[178] Although he has not stated so expressly, Mr. Merric's characterization of the UTC as regressive, and his reference to statutes authorizing asset protection trusts as progressive, suggest that a principal motive behind his criticism of the UTC may be his desire to see more widespread adoption of asset protection trust legislation.[179]

Reasonable people can differ as to the advisability of asset protection trust legislation. The UTC takes the traditional approach by rejecting asset protection trusts as a matter of public policy. Each

---

[174] The critics make a subsidiary claim that adopting the UTC will lead to a loss of work for trusts and estates lawyers and professional fiduciaries, as trust business migrates to other, non-UTC jurisdictions. Note that this is an argument that can be used anytime someone opposes legislation that may make other states' law more "favorable" for any purpose—the gist of the argument is that, once the legislation has been enacted, lawyers will be subject to malpractice liability anytime they fail to send work to lawyers in other states.

[175] *Arizona's Nightmare*, *supra* note 2, at 13.

[176] *Id.* (emphasis added).

[177] *See* Richard W. Nenno, *The Domestic Asset Protection Trust Comes of Age*, 38 HECKERLING INST. EST. PLAN. ¶¶ 202-06 (2004) (discussing the statutes in all five jurisdictions).

[178] *See supra* notes 70-83 and accompanying text.

[179] As described on the web site for his law firm, the use of asset protection trusts is apparently a significant focus of Mr. Merric's practice. *See* Merric Law Firm, LLC, Asset Protection Planning, http://www.internationalcounselor.com/ Serv-assetprotection.htm.

jurisdiction is free to make its own determination on this public policy question and can reject the UTC approach if it views asset protection trusts favorably. Moreover, enacting the UTC is not altogether inconsistent with asset protection trusts—the statute can be modified, as was done in Utah, expressly to permit them.[180] Thus, while it is true that the UTC follows the traditional approach in this regard, having done so should not be considered a deficiency in the statute.

IV. CRITICAL ANALYSIS OF THE CODE

This Part of the Article offers a normative analysis of particular elements of Article Five (and the closely related language of section 814), and concludes with some modest suggestions for reform.

A. *Abolishing the Distinction Between Support and Discretionary Trusts*

As earlier discussed, with respect to the claims of creditors the UTC draws no distinction between so-called support trusts and discretionary trusts.[181] This is accomplished (i) in section 504(b) by providing that, in general, a creditor may not compel a distribution that is subject to the trustee's discretion, regardless of whether the discretion is subject to a standard, and (ii) in section 504(c) by providing that, for certain types of creditors' claims, the creditor may compel distributions that are subject to the trustee's discretion, regardless of whether the discretion is subject to a standard.[182] The comment to section 504 makes clear that the distinction between the two types of trusts is abolished for creditors' rights purposes, but not for purposes of determining the rights of the beneficiaries. Moreover, section 506(a)

[180] *See* UTAH CODE ANN. § 75-7-505(1)(b) (2005) (creating an exception to UTC § 505(a)(2) for certain self-settled irrevocable trusts, as authorized by section 25-6-14 of the Utah Code).

[181] *See supra* notes 107-112 and accompanying text.

[182] The lack of this distinction in the UTC may also be reflected in section 501, under which, in the absence of a spendthrift provision, a creditor (including, arguably, a creditor without a support-related claim) may be able to reach the interest of a beneficiary (including, arguably, an interest for the beneficiary's support). This could not have occurred under the Restatement (Second). *See* RESTATEMENT (SECOND) OF TRUSTS § 154 (1959). On the other hand, section 501 also provides that "[t]he court may limit the award to such relief as is appropriate under the circumstances," suggesting that a court might not allow a non-support creditor to recover from a trust for the beneficiary's support. UNIF. TRUST CODE § 501 (2005). Whether a court would be likely to allow the claim would presumably depend, in part, on the nature of the non-support claim and on whether the assets of the trust were more than adequate to provide for the beneficiary's support needs.

and the accompanying comment make clear that an interest in a trust subject to a standard will be considered discretionary, not mandatory, for purposes of determining the rights of creditors.[183]

The conceptual foundation for the common law distinction between support and discretionary trusts depends on the notion that a beneficiary with an interest in a trust from which trust distributions were to be used for specific purposes should not be allowed to transfer his or her interest—to do so would be inconsistent with the purposes for which the trust was created.[184] Similarly, allowing a creditor (other than one who had furnished so-called necessaries) to reach the beneficiary's interest would be inconsistent with the settlor's intent. Thus, the rule developed that a support trust and a spendthrift trust were treated similarly for purposes of creditors' rights.[185]

Implicit in this conceptual framework is that the trustee of a support trust has little or no discretion in making distributions. The prototype of such a trust would, for example, provide that the trustee "shall distribute to or for the benefit of the beneficiary as much of the income and principal of the trust as shall be necessary for the beneficiary's support and health." Note how this prototypical language creates both a floor limiting the trustee's ability to withhold distributions and a ceiling limiting the trustee's ability to make distributions. In theory, the trustee is not exercising discretion at all, but simply fulfilling the administrative task of implementing the dispositive provisions of the trust.[186]

In practice, however, few, if any, beneficial interests subject to a standard are not also subject to the trustee's discretion. Even with respect to the apparently discretion-free language in the example above, the trustee arguably must exercise his judgment concerning the meaning of "support" and "health," the amounts necessary to satisfy the beneficiary's support and health care needs, the appropriate timing of distributions, whether distributions should be made directly to the beneficiary or instead directly to his support and health care providers, etc. Moreover, as a practical matter, in most cases of beneficial interests subject to a standard, the trustee is expressly granted discretion. Thus, the preceding example might have provided that the

---

[183] UNIF. TRUST CODE § 506(a).

[184] *See* RESTATEMENT (SECOND) OF TRUSTS § 154 cmts. b, c.

[185] *See id.* (providing generally that a creditor cannot reach a beneficiary's interest in a support trust or a spendthrift trust); *see also id.* § 157 (providing that certain classes of creditors can reach a beneficiary's interest in a support trust or a spendthrift trust).

[186] Similarly, a general power of appointment that is subject to an ascertainable standard relating to the health, education, support, or maintenance of the power holder is treated as non-taxable for purposes of the federal estate and gift taxes. *See* I.R.C. §§ 2041(b)(1)(A), 2514(c)(1) (2000).

trustee "*may* distribute to or for the benefit of the beneficiary as much income and principal of the trust as the trustee *shall deem necessary* for the beneficiary's support and health." In this example, the granting of discretion to the trustee is explicit, not implicit.

Should a court scrutinize the actions of the trustees in these two examples differently? Possibly yes, but articulating how that scrutiny should differ is challenging. This difficulty, and the apparent arbitrariness of drawing bright-line distinctions between support trusts and discretionary trusts, led the drafters of the Restatement (Third) (and, later, the drafters of the UTC) to abolish the distinction for some purposes.[187]

For several reasons, abolishing this distinction in the context of creditors' claims is a sensible statutory approach. First, as the foregoing discussion demonstrates, determining the nature of a beneficiary's interest is a more subtle exercise than the arbitrary distinction between support trusts and discretionary trusts might suggest. Second, with respect to limiting creditors' claims under section 503(b), a distinction between the two types of trusts is probably unnecessary, the UTC having abolished the preferred status of suppliers of necessaries.[188] Third, with respect to claims by the preferred creditors identified in section 503(c), there seems to be little reason to distinguish between the two types of trusts. If anything, allowing such a creditor to reach the assets of a support trust but not the assets of a wholly discretionary trust may actually do greater violence to the intent of the settlor; depending on the precise terms of the trust, a settlor creating a trust for the beneficiary's support may be more concerned about preserving assets

---

[187] RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. a (2003). As explained in the Reporter's Notes to comment a:

> Not only is the supposed distinction between support and discretionary trusts arbitrary and artificial, but the lines are also difficult—and costly—to attempt to draw. Attempting to do so tends to produce dubious categorizations and almost inevitably different results (based on fortuitous differences in wording or maybe a "fireside" sense of equity) from case to case for beneficiaries who appear, realistically, to be similarly situated as objects of similar settlor intentions. . . .
>
> . . . .
>
> The fact of the matter is that there is a *continuum of discretionary trusts*, with the terms of distributive powers ranging from the most objective (or "ascertainable," IRC § 2041) of standards (pure "support") to the most open ended (e.g., "happiness") or vague ("benefit") of standards, or even with no standards manifested at all (for which a court will probably apply "a general standard of reasonableness").

Id. (emphasis added).

[188] The point is that, under the common law, as exemplified by the Restatement (Second), in general a creditor could reach the beneficiary's interest in neither a support trust or a discretionary trust. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 154, 155(1) (1959). A supplier of necessaries, however, could reach a beneficiary's interest in a support trust. *Id.* § 157(b), (c). Abolishing the preferred status of supplier of necessaries thus partially obviates the need for a distinction between the two types of trusts under the UTC.

for the beneficiary (and thus sheltering those assets from creditors claims) than a settlor who creates a trust that is wholly discretionary.

B. *The Good Faith Standard of Section 814(a)*

As discussed in Part III.D, the UTC critics claim that the good faith standard of section 814(a) subjects a trustee holding extended discretionary powers to a higher level of scrutiny than at common law. Part III.D refutes this claim, but it engages in no normative analysis of the good faith rule. This Part of the Article considers the good faith rule as a normative matter.[189] It also examines the apparent requirement under the Restatement (Third) that a trustee act "reasonably."

Section 814(a) of the UTC provides that

> [n]otwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute", "sole", or "uncontrolled", the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.[190]

Section 814(a) is a mandatory rule, meaning that it cannot be varied by the terms of the trust.[191] The UTC further provides in section 1008, also a mandatory rule,[192] that

> [a] term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it . . . relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries.[193]

---

[189] Note that this issue—the degree of scrutiny of trustees making discretionary distributions—is of limited relevance as far as creditors' rights are concerned. This is because, under section 504(b), most creditors have no ability to compel discretionary distributions; in other words, they do not stand in the beneficiary's shoes in this respect. The issue is relevant, however, under section 504(c), because a creditor child or spouse does have the ability to compel discretionary distributions under limited circumstances. The issue is also arguably relevant to (i) whether the trust interest is a countable resource for purpose of needs-based government benefits and (ii) whether the trust interest may affect the economic circumstances of the beneficiary for purposes of alimony and child support awards.

[190] UNIF. TRUST CODE § 814(a) (2005).

[191] *See id.* § 105(b)(2) (providing that "[t]he terms of a trust prevail over any provision of this [Code] except . . . the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries") (second alteration in original). Note that section 105(b)(1) was amended in 2005 to make its language consistent with the language of section 814(a). *See id.* § 105 cmt. (discussing 2005 amendment, and noting that no substantive change was intended).

[192] *See id.* § 105(b)(10) (providing that "[t]he terms of a trust prevail over any provision of this [Code] except . . . the effect of an exculpatory term under Section 1008").

[193] *Id.* § 1008(a)(1).

Thus, under the UTC, it is impossible to create a trust in which the trustee is not required to act in good faith.

Should a trustee be required to act in good faith? Stated another way, should the law permit a settlor to relieve a trustee from the obligation to act in good faith? The answer to the second question depends on whether the settlor intends to create a trust, or whether the settlor instead intends to create some other type of property management arrangement, for example, a power of appointment, as discussed below. But the essential attribute of a trust is the establishment of a fiduciary relationship, and a fiduciary relationship cannot exist if the person controlling investment and distribution decisions has no enforceable duties toward others.[194] Moreover, an essential attribute of being a fiduciary is that you must place your personal financial interests secondary to the interests of the beneficiaries and that you must be impartial in your dealing with beneficiaries. Relieving a fiduciary of the obligation to act in good faith would thus be anathema to being a fiduciary; it would, in effect, mean that the trust would be unenforceable, an illusory arrangement in which the trustee would be beholden to no one. Thus, the answer to the first question must be "yes." One can think of little associated with being a fiduciary that is more important than the notion that the fiduciary must act honestly and with motives that are consistent with the purposes of the trust and the interests of the beneficiaries.

As explained by Professor Langbein, the good faith requirement "serves a truth-in-labeling policy":

> A settlor who wishes to benefit T, the trustee, may do so. For example, the settlor may grant T, the trustee, a general power of appointment, which would allow T to appoint some or all of the trust property to T personally, but the settlor must identify the interest in that way. The settlor may not get that result by dispensing with good faith administration of the trust, thereby allowing the trustee to loot the trust. This insistence on correct labeling, in addition to promoting efficient judicial administration, serves protective and cautionary functions. The suspicion is ever present that a term dispensing with good faith trust administration may not have been properly disclosed to the settlor, or that the settlor may not have under its effect. . . . The mandatory rule against bad faith trusteeship can be understood to operate as a presumption that trust terms authorizing bad faith must have been improperly concealed from the settlor or otherwise misunderstood by the settlor when propounded,

[194] This does not mean, of course, that the trustee cannot also be a beneficiary, but the sole trustee cannot be the sole beneficiary—the nature of a trust requires that the trustee owe a duty to someone other than himself or herself.

> because no settlor seeking to benefit the beneficiary would expose the beneficiary to the hazards of bad trusteeship.[195]

Professor Langbein's example compares a trust with a *general* power of appointment, under which the power-holder can benefit himself or herself. But a similar comparison can be made between a trust and a *non-general* power of appointment, under which the power-holder can appoint to a class of persons that does not include himself or herself. If the settlor wishes to relieve T from the obligation to distribute property among others in good faith, the settlor may do so by creating a non-general power of appointment.[196] In other words, the requirement that a trustee act in good faith is directed not just against looting by the trustee, but also against the trustee failing to act impartially. Bearing in mind the distinction between a trustee and the donee of a power of appointment, it is clear that the UTC does not require all parties to a trust to act in good faith; rather, it imposes this requirement only on trustees.

As Professor Newman observes, an examination of cases from areas other than trust law reveals that the obligation to act in good faith is inextricably associated with being a fiduciary.[197] Moreover, even outside the fiduciary context, the law frequently imposes an obligation to act in good faith. For example, the Uniform Commercial Code establishes an obligation to act in good faith, even in the context of arms' length business transactions.[198] To suggest that a *fiduciary* should be held to a lower standard than parties who contract with one another seems patently absurd.

A further question is whether a trustee granted extended discretion is or should be subject to a reasonableness requirement. The origin of this issue lies apparently in the Restatement (Second), which suggests that under certain circumstances the conduct of a trustee should be evaluated by a subjective (rather than an objective) standard. For example, comment i to section 187[199] states that:

---

[195] John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1124 (2004).

[196] A power of appointment is not a fiduciary power and thus may be exercised arbitrarily, as long as it is exercised consistent with its terms. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. a (2003). Thus, for example, if a settlor wishes for a person to have the power to distribute income among a group of beneficiaries with no obligation to allocate distributions among the recipients in good faith, the settlor can grant the person a non-general power.

[197] *See* Newman, *supra* note 123, at 617-18 n.254 (citing cases involving insurers and insureds; personal representatives and beneficiaries of an estate; physicians and patients; principals and agents; etc.).

[198] *Id.*

[199] Section 187 provides that "[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion." RESTATEMENT (SECOND) OF TRUSTS § 187 (1959).

> The nature of the power conferred upon the trustee . . . may be such that there is no standard indicated by the terms of the trust by which the reasonableness of his conduct in exercising or failing to exercise the power can be judged. In such a case, however, the court will interpose *if the trustee acts dishonestly, or from some improper motive*. Thus, if power is conferred upon the trustee to appoint income or principal in favor of a particular beneficiary if he so chooses, without any reference to the needs of the beneficiary, the court will not interpose if the trustee acts honestly and from proper motives.[200]

Note that this passage suggests that the trustee will not be in breach of his duties as long as he subjectively believes his conduct to be appropriate, even if the conduct may not be reasonable under an objective standard. Comment j to section 187 further provides:

> The extent of the discretion conferred upon the trustee depends primarily upon the manifestation of intention of the settlor. The language of the settlor is construed so as to effectuate the purposes of the trust. The mere fact that the trustee is given discretion does not authorize him to act beyond the bounds of a reasonable judgment. *The settlor may, however, manifest an intention that the trustee's judgment need not be exercised reasonably*, even where there is a standard by which the reasonableness of the trustee's conduct can be judged. This may be indicated by a provision in the trust instrument that the trustee shall have "absolute" or "unlimited" or "uncontrolled" discretion. These words are not interpreted literally but are ordinarily construed as merely dispensing with the standard of reasonableness. *In such a case the mere fact that the trustee has acted beyond the bounds of a reasonable judgment is not a sufficient ground for interposition by the court, so long as the trustee acts in a state of mind in which it was contemplated by the settlor that he would act.* But the court will interfere if the trustee acts *in a state of mind not contemplated by the settlor*. Thus the trustee will not be permitted to act dishonestly, or from some motive other than the accomplishment of the purposes of the trust . . . .[201]

Note, again, that according to the Restatement (Second), in the case of extended discretion, a trustee will not be considered in breach of his or her duties as long as he or she acts with a particular state of mind. This is a subjective, not an objective, test.

Interestingly, as noted by numerous other observers, there seems to be little case law support for the Restatement (Second) position. For example, according to Professor Bogert, "[t]he authorites do not appear to support the Restatement [Second] position that there is no requirement of reasonableness in the exercise of a power granted in the

[200] *Id.* § 187 cmt. i (emphasis added).
[201] *Id.* § 187 cmt. j (emphasis added).

trustee's absolute discretion."[202] To the contrary, Professor Bogert concludes that

> [i]n addition to the commonly recognized factors used to determine whether there had been an abuse of discretion, a standard of reasonableness has been applied by the courts in judging the exercise of a discretionary power (whether simple or absolute), a standard implied from the settlor's intent and the purposes expressed in the trust instrument. With respect to court review of discretionary powers, this standard is consistent with the standard of care and skill of a prudent man and is based upon established fiduciary standards and principles.[203]

Similarly, the Restatement (Third) observes that there are few, if any cases, in which extended discretionary language has been construed to excuse unreasonable conduct.[204] Professors Dukeminier, Johanson, Lindgren, and Sitkoff are similarly skeptical that the case law supports the Restatement (Second)'s position.[205]

As discussed earlier, the UTC properly requires a trustee to act in good faith, even in cases of extended discretion. It would similarly be inconsistent with the concept of a fiduciary to excuse unreasonable conduct by a trustee. A purely subjective standard for measuring trustee conduct is insufficient, because it could excuse highly questionable actions by a trustee as long as the trustee subjectively believed his or her actions to be appropriate. Consider, for example, a trust under which the trustee is authorized to "distribute income and principal in such amounts and for such purposes as the trustee deems appropriate in the trustee's sole and absolute discretion"—in other words, a wholly discretionary trust with language granting the trustee extended discretion. Suppose the beneficiary, through no fault of his own, is destitute, but the trustee nevertheless refuses to pay for an objectively necessary medical procedure, believing in good faith that the beneficiary will recover from his condition without medical intervention. In the absence of a standard of reasonableness, the trustee's refusal to make a distribution may not be subject to review.[206]

---

202 BOGERT & BOGERT, *supra* note 127, § 560, at 217-18.

203 *Id.* § 560.

204 RESTATEMENT (THIRD) OF TRUSTS § 50 reporter's note on cmt. c (2003).

205 JESSE DUKEMINIER ET AL., WILLS, TRUSTS, AND ESTATES 540-41 (7th ed. 2005) (concluding that "the difference between simple discretion and 'absolute' discretion is one of degree and that the trustee's action must not only be in good faith but also to some extent reasonable, with more elasticity in the concept of reasonableness the greater the discretion given").

206 This is an extreme example, but it demonstrates that a subjective standard of good faith would not necessarily protect against all undesirable conduct by a trustee. Presumably, virtually all courts would intercede on behalf of the beneficiary under these facts; some courts would hold that the trustee failed to act reasonably, others that the trustee had failed to act in good faith. But note that a court holding that the trustee failed to act in good faith under these facts, in effect,

Moreover, a purely subjective standard would impose an undue burden of proof on beneficiaries seeking to challenge a trustee's actions—in most cases, only the trustee would know whether he or she was acting in good faith, and evidence to the contrary would be difficult or impossible to produce.

C. *The Power to Compel Distributions Under Section 504(c)*

Section 503(b)(1) of the UTC exempts certain claims of children, spouses, and former spouses from the effects of a spendthrift provision. The effect of the section 503(b)(1) exemption is to permit the claimant to attach trust distributions that otherwise would be made to the beneficiary;[207] the provision does not authorize the claimant to compel a distribution from the trust. Thus, the exemption entitles the claimant to receive mandatory distributions,[208] as well as distributions that the trustee decides to make in its discretion. In the case of a wholly discretionary trust, a trustee in its discretion could determine to withhold all distributions, in which case the section 503(b)(3) exemption would provide the claimant with no access to the beneficiary's interest.

As discussed earlier, section 504(c) of the UTC provides that a court may order a trustee to make a distribution from a trust for purposes of satisfying certain claims of children, spouses, and former spouses, but only to the extent that the trustee is determined to have failed to comply with a standard or has abused a discretion. Section 504(c) thus fills in a gap left by section 503(b)(1)—it permits those claimants to compel distributions under limited circumstances, thus preventing a trustee under those circumstances from withholding distributions for the purpose of defeating their claims.

One of the critics' principal objections to the UTC is that section 504(c) expands the rights of these categories of creditors beyond the rights held by them at common law.[209] In some respects they are correct, in the sense that a child, spouse, or former spouse under certain circumstances could theoretically compel distributions from a wholly discretionary trust (as opposed to a trust with a support standard),[210]

would be imposing an objective standard on the conduct of the trustee, the subjective intentions of the trustee being insufficient to protect the trustee from liability. Thus, even courts claiming not to impose a standard of reasonableness may in fact often be doing so.

[207] UNIF. TRUST CODE § 503 cmt. (2005).

[208] This is subject, of course, to the court's authority to limit the claimant's award, after taking into account the financial circumstances of the beneficiary. *See id*. § 503 (c) & cmt.

[209] *See supra* notes 90-92 and accompanying text.

[210] *See supra* notes 116-118 and accompanying text.

which generally would not be possible at common law. On the other hand, the claimant's power under section 504(c) is quite limited—to prove abuse of discretion in many cases would be either a difficult or an insurmountable task.[211]

Putting aside the question whether children, spouses, and former spouses with support claims merit special treatment for creditors' rights purposes,[212] having decided to exempt these creditors from the effects of a spendthrift provision under section 503(b)(1), did the drafters of the UTC take the right approach in granting these creditors the power to compel distributions under certain circumstances under section 504(c)? In one sense, if creditors with these types of claims merit special treatment, then section 504(c) is appropriate; otherwise, the benefits conferred upon them by section 503(b)(1) could largely be negated through careful drafting—limiting the beneficiary's interest to the discretion of the trustee would significantly reduce the likelihood that one of these claimants would ever receive a distribution. In this sense, section 504(c) is necessary in order to give the protections of section 503(b)(1) any teeth. Section 504(c) is also consistent with the notion—largely rejected by section 504—that a creditor to whom a spendthrift provision does not apply should stand in the shoes of the beneficiary. On the other hand, as noted earlier, the powers held by a claimant under section 504(c) are limited, and in many cases the provision would do little to increase the likelihood of a claimant receiving a distribution.

Is section 504(c) in any respect objectionable, putting aside again the question whether these categories of claimants are worthy of greater protection? In my view, the answer is "no." The principal normative objection to section 504(c) would seem to be that it is inconsistent with the typical settlor's intent. However, if a legislature determines that these categories of creditors' claims should be exempt from spendthrift protection, it has implicitly decided that the settlor's intent must give

[211] Nevertheless, section 504(c) does provide an element of protection to children, spouses, and former spouses. Although it may be difficult for one of these claimants to compel distributions in most cases, the claimants are nonetheless exempt from any spendthrift limitations and thus are entitled to receive distributions that the trustee otherwise chooses to make, subject to the court's power to limit their awards. Considering the nature of their claims, it seems unlikely that a court would be willing to allow a beneficiary to receive substantial distributions without also allowing the claimant to receive distributions. To avoid the claims altogether, the trustee might be forced to withhold distributions altogether, but this would increase the possibility that there would be an abuse of discretion or failure to satisfy a standard for purposes of section 504(c). In sum, sections 503 and 504, read together, probably do expand the rights of these claimants as a practical matter. *See* UNIF. TRUST CODE §§ 503, 504(c).

[212] Notably, a number of jurisdictions have limited the special rules of sections 503(b)(1) and 504(c) to *children only*, relegating spouses and former spouses to the status of ordinary creditors. *See, e.g.*, VA. CODE ANN. §§ 55-545.03.B, 55-545.04.C (2005). This is a principled modification of the statute, for the obvious reason that a spouse or former spouse is on more equal footing with the beneficiary than is a child.

way to public policy. Granting those creditors limited rights to compel discretionary distributions is no less consistent with the settlor's intent, and is consistent with the general public policy determination that certain categories of claimants should have protected status.

D. *Some Modest Suggestions for Reform*

This section of the Article offers some modest suggestions for improvements to Article Five and section 814(a).

1. Clarifying or Modifying the Relationship Between Sections 501 and 503

Section 501 of the UTC describes the rights of a beneficiary's creditors if the beneficiary's interest is not subject to a valid spendthrift provision. Under section 501, if a beneficiary's interest in a trust is not subject to a spendthrift provision, "the court may authorize a creditor . . . of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."[213] Compare section 501 with section 503(b), which describes the rights of an exception creditor: such a claimant "may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary."[214] The key difference between the two provisions is that section 501 allows a court to authorize a creditor to reach the beneficiary's interest not just by attachment of present or future distributions, but also *by other means*. In the original version of the UTC passed by NCCUSL in 2001, the comment to section 501 offered the following explanation:

> A creditor typically will pursue a claim by serving an order on the trustee attaching the beneficiary's interest. Assuming that 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, as well as discretionary distributions the trustee decides to make. *The creditor may also, in theory, force a judicial sale of a beneficiary's interest.*[215]

The quoted language was omitted from the comment in connection with amendments to section 501 in 2005. The comment now provides

---

[213] UNIF. TRUST CODE § 501.
[214] *Id.* § 503(b).
[215] *Id.* § 501 cmt. (2001) (emphasis added).

simply that "[t]his section does not prescribe the procedures ("other means") for reaching a beneficiary's interest . . . , leaving [that] issue[] to the enacting State's laws on creditor rights."[216] In explaining the 2005 changes, the comment further states that "[c]larifying changes are . . . made in the comments and unnecessary language on creditor remedies are omitted."[217] Thus, the drafters apparently believed that the earlier comment about a possible judicial sale of a beneficiary's interest was unnecessary, because local law (outside the UTC) either would or would not provide such a remedy. Nevertheless, the drafters clearly contemplated that such a remedy might be available under appropriate circumstances for actions brought by creditors under section 501. The comment to section 503 offers no additional explanation for the differences between the two provisions, but it is apparent that the drafters contemplated that judicial sales would *not* be available under section 503. The comment to section 503 mentions no remedies other than attachment of present or future distributions. Moreover, an earlier version of the comment stated that section 503 "does not authorize the spousal or child claimant to force a sale of the beneficiary's interest."[218] This distinction between the approaches of sections 501 and 503(b) is consistent with the Restatement (Third).[219]

The distinction between sections 501 and 503 should have little practical significance in most cases, because only rarely will a trust fail to include a spendthrift provision protecting each of the beneficial interests. Nevertheless, if the drafters intend for the remedies under the two provisions to differ, which appears to be the case, it would be helpful to make this point explicit in the comments to both provisions.

As to whether the distinction is appropriate, this is a question on which reasonable people can differ. In one respect, the distinction makes little sense—if, as a matter of policy, a state determines that a spendthrift provision should be ineffective with respect to certain types of claims, then it would seem appropriate to grant exception creditors the full panoply of remedies available to creditors in the case of non-spendthrift trusts. Under this approach, a spendthrift provision would either be effective or not—thus, for example, the claim of a child with a support order could be satisfied in the same manner, regardless of whether the trust includes a spendthrift provision. This approach would

[216] *Id.* § 501 cmt. (2005).

[217] *Id.*

[218] *See* RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. b (2003) (citing an earlier version of the comment to section 503(b)).

[219] *See id.* § 56 cmt. e (providing, in the case of trust with no spendthrift provision, that the court may order a judicial sale of the beneficiary's interest); § 59 cmt. b (providing that, at least in the case of claims by children, spouses, and former spouses for support, an exception creditor cannot force a sale of the beneficiary's interest).

also simplify the UTC, because the remedies prescribed in section 503 would be superfluous.

On the other hand, the distinction between sections 501 and 503(b) may simply reflect a reasonable political compromise, between those who would prefer that spendthrift protection be absolute and those who would prefer that it be completely ineffective with respect to certain categories of claimants. In effect, the UTC provides that, with respect to certain categories of claimants, there is quasi-spendthrift protection, under which the claimant can attach present or future distributions, but cannot force a judicial sale of the beneficiary's interest. Because that appears to be the intended effects of sections 501 and 503, the point should be made explicit.

2. Clarifying or Modifying the Comment to Section 814(a)

As discussed earlier, section 814(a) imposes on trustees a non-waivable duty to act in good faith, which, as argued earlier, is consistent with a trustee's duties at common law. Section 814(a) does not itself address the question of whether a trustee is also required to act reasonably, although the issue is addressed in the comment, as amended in 2005:

> Subsection (a) requires a trustee to exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to Restatement (Second) of Trusts Section 187 (1959), subsection (a) does not impose an obligation that a trustee's decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee's judgment can be tested. Restatement (Second) of Trusts Section 187 cmt. f (1959).[220]

As observed earlier, the comment refers to the distinction in the Restatement (Second) between discretion subject to a standard and discretion in the absence of a standard,[221] but it does not refer to the Restatement (Second)'s distinction between ordinary discretion and extended discretion,[222] the drafters apparently intending to leave this question to the common law.

---

[220] UNIF. TRUST CODE § 814 cmt.

[221] *See supra* notes 139-141 and accompanying text. According to the Restatement (Second), a reasonableness requirement is imposed only if there is a standard against which it can be measured.

[222] *See supra* note 141 and accompanying text. According to the Restatement (Second), the use of extended discretion dispenses with the reasonableness requirement.

The apparent purpose of the 2005 change in the comment was to refute the argument of some critics that the good faith standard of section 814(a) means that a trustee must also always act reasonably. In my view, for at least two reasons, the 2005 change was ill advised. First, assuming that it is appropriate to relieve trustees from a standard of reasonable conduct, the comment should make clear whether the drafters intend that to be true, as in the Restatement (Second), if the instrument grants the trustee extended discretion. Second, and more fundamentally, in my view it is inappropriate to suggest that, under some circumstances, a trustee may be relieved from a standard of reasonableness. As observed,[223] the Restatement (Second) approach to this question seems to have little support at common law and is inconsistent with the concept of a fiduciary.

CONCLUSION

This Article is, ultimately, a defense of Article Five: though imperfect, Article Five does not do what the critics claim. It does not undermine spendthrift protections; in fact, in many respects, it actually strengthens them. Moreover, contrary to the critics' claims, Article Five does not constitute a significant departure from the common law. Where it does so depart (or with respect to questions for which the common law fails to provide a clear rule), Article Five strikes an appropriate balance between the interests of settlors and their beneficiaries and the interests of creditors. At best, the critics' claims about Article Five are misinformed or misguided; at worst, they are deceptive. Most importantly, the arguments of the critics should not be permitted to impede further adoptions of the UTC.

[223] *See supra* notes 202-206 and accompanying text.