

## Question 6

In 2003, Sam executed a valid testamentary trust, naming Tom as trustee. The terms of the trust state:

- (a) All net income is to be paid to Bill, Sam's nephew, for life;
- (b) Tom may invade principal for Bill in such amounts as Tom, in his sole and absolute discretion, determines;
- (c) The trust terminates on Bill's death and any remaining principal is to be distributed to Alma Mater University;
- (d) The interests of the beneficiaries are inalienable and not subject to the claims of creditors.

In 2004, Sam died.

In 2005, Lender obtained a judgment against Bill for an unpaid credit card bill that includes charges for tuition, groceries, and stereo equipment. Lender now requests a court order directing Tom to pay all future installments of trust income to it rather than Bill until the judgment is satisfied.

Bill is delinquent in making child support payments to Kate, his former spouse, for their child. Kate now requests a court order directing Tom to pay all future installments of trust income to her rather than Bill until the arrearages are eliminated.

Bill wants Tom to invade the trust principal so Bill can promote a newly-formed rock band, but Tom has refused. Bill now requests a court order directing Tom to invade the trust principal.

Because of Tom's refusal to invade the trust principal, and because Alma Mater is concerned over Bill's debt difficulties, Bill and Alma Mater wish to terminate the trust in order to divide the trust principal, but Tom has refused. Both Bill and Alma Mater now request a court order terminating the trust.

How should the court rule on the requests made by Lender, Kate, Bill, and Alma Mater? Discuss.

## Answer A to Question 6

A trustee is a fiduciary relationship with respect to property where a settlor transfers property to a trustee who holds the property for the benefit of named beneficiaries, for a valid trust purpose. On the facts, Sam executed a valid express testamentary trust naming Tom as the trustee and Sam and Alma Mater University as beneficiaries. Sam has a life interest in the trust and Alma Mater has a remainder interest.

### ① Request by Lender

The express trust created creates a spendthrift clause under (d). As a general rule, a beneficiary's interest is both voluntarily and involuntarily alienable as a property right. Involuntary alienation allows a creditor to attach to the beneficiary's rights to future payments by obtaining a judgment.

A spendthrift clause is designed to protect the beneficiary from their spendthrift ways by prohibiting both voluntary and involuntary alienation of the beneficiary's right to future payments. Thus the spendthrift clause created in (d) prohibits Lender from attaching to Bill's future payments of income. The provision explicitly state's [sic] that the beneficiaries' interest is inalienable and not subject to creditor's claims.

However, the courts recognize exceptions to the protection provided by spendthrift provisions including where a creditor has provided necessities to the beneficiary. Necessaries include items such as food, clothing, shelter and medical care.

On the facts, Lender provided Bill with tuition[,] groceries[,] and stereo equipment. A court would likely find that only the groceries were necessities and would order that Lender be entitled to payment for the groceries from the income of the trust. Thus a court would likely grant Lender's requested order for payment of Bill's grocery debt.

With respect to the stereo and tuition, Lender could seek recovery based on surplus. The concept of surplus is recognized in some jurisdictions and allows a creditor to attach to future payments to the beneficiary despite a spendthrift clause where the income to be paid exceeds the beneficiaries['] station in life, thus resulting in a surplus. On the facts it is unclear what income is produced in relation to Bill's station in life. In making the determination as to whether surplus exists the court will only consider Bill's reasonable expenses. If Lender can establish surplus, a court would likely grant his requested order and direct Tom as trustee to pay future installments of surplus to Lender to satisfy Bill's debt.

### ② Request by Kate: Preferred Creditor

In addition to the two exceptions noted in relation to Lender, the courts have also recognized an exception for preferred creditors.

A court will disregard a spendthrift clause and allow a preferred creditor to attach to the beneficiary's future income payments from the trust. Preferred creditors include government debt and outstanding child and spousal support and alimony payments.

On the facts, the beneficiary Bill has failed to make child support payments to his former spouse Kate for the support of his child. Thus Kate is a preferred creditor and is entitled to attach to Bill's right to future income from the trust to satisfy the delinquent child support.

Therefore, a court would likely grant Kate's request and order Tom to pay trust income to Kate in satisfaction of Bill's outstanding child support obligation until the arrearages are eliminated.

### ③ Request by Bill - Discretionary Trust Provision

Under the terms of the will, Tom has sole and absolute discretion to determine whether or not to invade the trust principle [sic] for Bill's benefit. Tom as trustee has all express powers as set out in the trust and all implied powers required to exercise the express powers. As a fiduciary, Tom has an obligation to exercise his discretion in good faith. On the facts, there is no indication that Tom's refusal to invade the trust principal to allow Bill to promote the rock band was made in bad faith.

Therefore, based on the facts, the court would not interfere with Tom's discretion as explicitly set out in the trust and would deny Bill's request. The court would not therefore order Tom to invade the trust principal.

### ④ Request by Alma Mater & Bill - Termination

A court will not order a termination of a trust even with the consent of all beneficiaries where such termination would be in violation of the trust purposes and would be contrary to the testator's intent.

The trust established by Sam evidences a clear intent to provide for Bill during his lifetime. This is a valid trust purpose which continues until Bill's death. On the facts, Bill is still alive and thus the trust purpose is ongoing. As well, the termination of the trust would destroy Sam's intent to provide for Bill throughout Bill's life.

In addition, the trust has not become passive as Tom, the trustee, still has active duties in maintaining and managing the trust. Nor have circumstances changed such that the doctrine of changed circumstances would apply to modify the trust terms.

Therefore, the court would uphold Tom's refusal to terminate the trust and would deny Bill and Alma Mater's request since termination would destroy the settlor/testator (Sam's) intent.

### **Answer B to Question 6**

Trust actions are governed by the trust document.

#### Valid Trust

A valid inter vivos trust was created since Sam (S), the settlor, had an immediate intent to create a trust for a legal purpose, and delivered a presently existing res, title property interest, to Tom (T), the trustee, for the purposes of management for the benefit of the beneficiaries Bill (B) and Alma Mater (AM).

#### Type of Trust

##### Income

B has a life interest in the income of the trust, subject to its provisions.

##### Mandatory Distributions (Provision A)

The trust sets out mandatory distributions of income to B by T. T must then distribute the income to B.

##### Spendthrift Provision (Provision D)

All distributions, both income and principal, are subject to a spendthrift provision. This prevents creditors from attaching and beneficiaries from voluntary [sic] assigning their rights. This is held as valid restraint. B & AM may not alienate nor may creditors attach. There are, however, exceptions to the creditor[']s rule discussed below.

##### Principal

##### Discretionary to Bell (Provision B)

T is given discretionary power to distribute principal to B. T is thus not required to distribute any principal and may distribute as he feels is necessary) [sic][.]

##### AM (Provision C)

AM has a right to all of the principal remaining at B's death subject to the spendthrift limitation.

## T's Fiduciary Duty

Trustees are subject to fiduciary duties. T is thus bound to follow the provision set out by the trust. As such, his actions below with the individuals are governed by the document provisions discussed above.

## Parties['] Requests

### Lender

As explained, as a spendthrift trust, creditors may not normally attach and T cannot be required to pay off the court order. Exceptions for creditors are made for the following creditors: government creditors, tort judgments, spousal or child support, alimony, necessities and surplus above station.

Here, Lender seeks reimbursement for groceries, a necessity. Since courts want beneficiaries to be able to obtain necessities based on credit, this exception exists and reimbursement may be made. Lender may also argue tuition is a necessity but this is likely to fail[.]

The right to collect for the stereo equipment and education may come under the surplus exception. Creditors may attach to the income a beneficiary receives beyond that which is necessary to maintain their station in life.

It is unclear here what amount B receives and what amount his past lifestyle dictates is necessary for maintenance[.] Lender may have an argument and thus gain attachment. T will then be required to make payments to Lender[.]

### Kate

Again, the income to B is subject to the spendthrift provisions. Kate, however, has a claim under the exception for child support payments, since this is a creditor that courts have felt should not, in equity and public policy, be excluded. Kate may attach and require T to make payments to her. Her order ought to be granted.

### Bill

Bill's order will fail. The trustee[']s fiduciary duties to the trust are governed by the document and T is granted discretion in his allocation of principal to B. T's decision not to support B's rock band plans, especially in light of B's other monetary problems, is reasonable. T appears to be using his discretion to fulfill his duty of care, acting as a reasonably prudent person managing other people's money, under the circumstances.

Further, in using his discretionary powers, T must also adhere to his duty of loyalty to all beneficiaries. While AM only has a right to the leftover, he may also consider that all parties', including B's, best interests may be served investing the principal. B's order should be denied.

### Alma Mater

B&AM have both requested that the trust be terminated. A trust may be terminated where all the beneficiaries, including unborn beneficiaries represented by legal counsel, petition the court for determination. The court must also find that all of the purposes of the trust have been fulfilled.

While all the beneficiaries (present & future) are currently petitioning, B&AM, the court is likely to find that the trust's purposes have not been fulfilled. S created a trust that granted B a lifetime right in the income of the trust subject to a spendthrift clause[.]

It appears from the terms that S was attempting to insure for the provision of income to B, despite his issues with spending wisely. To prematurely cancel the trust would leave B without the protections that S intended. Cancellation would be directly at odds with this purpose.

Though it may fulfil the purpose of AM's gaining some of the principal, their express right in the trust is only to the remaining principal and not the most principal they can receive. Further, this purpose of S is best protected by T's discretionary power over the principal. B&AM's order to terminate should thus be denied.

Additionally, AM's concerns over the debts fail since B's right to the principal, AM[']s interest, is subject to T's discretion. Even if the creditors could attach under an exception, attached creditors to a discretionary interest only have a right to collect when T chooses to pay out. Only in that scenario is T required to pay the creditor. AM's interest is thus further protected and S's purposes are better furthered through the continuation of the trust and the order ought to be denied.